[JOINT COMMITTEE PRINT]

DESCRIPTION OF BILLS
(H.R. 1955, H.R. 1735, and H.R. 2375)
RELATING TO
DISTRESSED AREA TAX INCENTIVES

SCHEDULED FOR A HEARING

BEFORE THE

COMMITTEE ON WAYS AND MEANS

ON NOVEMBER 17, 1983

PREPARED BY THE STAFF

OF THE

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INTRODUCTION

The House Committee on Ways and Means has scheduled a public hearing on November 17, 1983, on proposals to target tax incentives to economically distressed areas. Testimony will be received on three bills. These include the Administration's proposal to provide tax and other incentives in designated enterprise zones in economically distressed areas; this proposal is contained in H.R. 1955 (introduced by Messrs. Conable, Gradison, Guarini, Schulze, Vander Jagt, Martin of North Carolina, Campbell, Thomas, and Duncan, Mrs. Kennelly, Messrs. Crane, Jenkins, Heftel, Flippo, Gephardt, Anthony, Hance, and others). The other bills to be considered at the hearing are H.R. 1735 (introduced by Mr. Mitchell and others) and H.R. 2375 (introduced by Messrs. Nowak and Williams of Ohio). The committee will receive testimony only on the revenue provisions of these bills.

This pamphlet, prepared in connection with the hearing, contains descriptions of the various provisions of the bills. Part I of the pamphlet is a summary of present law and the bills. This is followed (in parts II–IV) with descriptions of the provisions of the bills and the corresponding portions of present law. Part V is a list of issues related to the revenue provisions of the bills. Finally, an Appendix provides a summary description of area eligibility criteria for Urban Development Action Grants (UDAG).

I. SUMMARY

Present Law

Revenue provisions

Targeted area

The Internal Revenue Code contains only a few provisions for targeting geographic areas for special tax treatment. Code section 103A, relating to mortgage subsidy bonds, defines targeted areas for the purpose of promoting housing development with these areas. Within such areas, defined on the basis of the income of area residents or the general economic condition of the area, rules for the issuance of mortgage subsidy bonds are less restrictive than the generally applicable rules. In addition, certain domestic corporations deriving income from Puerto Rico and possessions of the United States are eligible for a tax credit that eliminates U.S. tax on that income.

Tax credits for employers

Present law contains no provisions under which an employer's tax liability varies according to the location of its employees. Prior law contained the new jobs credit, which provided a tax credit, for 1977 and 1978, based on the increase in the employer's payroll over that of the prior year. Under present law, the targeted jobs tax credit provides a tax credit for a portion of wage payments made to certain groups of employees. These groups generally are defined according to the individual's physical condition, participation in a specified education or rehabilitation program, and economic status.

Tax credit for employees

Under present law the tax liability of an employee working in the United States generally does not vary according to the location of his employment. The earned income credit provides a refundable tax credit for a portion of earned income (wages, salaries, and earnings from self-employment) to families with children and with income less than $10,000.

Expensing and investment tax credit for depreciable property

Under present law, a 10-percent regular investment tax credit applies to eligible tangible personal property used in a trade or business or for the production of income. Only a limited amount of used property is eligible for the credit. In addition, the credit applies to expenditures to rehabilitate buildings which are at least 30 years old. The basis of the property is reduced by one-half (or, in the case of certain rehabilitation credits, by the full amount) of the investment credits allowed for the property. (See also energy tax

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credits, below.) The credit is nonrefundable, i.e., it is limited to the taxpayer's tax liability.

Instead of claiming an investment credit and recovering costs of personal property under the ACRS system, businesses may elect to expense up to $5,000 of such property for 1983, $7,500 in 1985 and 1985, and $10,000 thereafter.

Capital gains taxation

Gain from the sale or exchange of a capital asset is taxable at reduced rates (a maximum 20 percent rate for noncorporate taxpayers and 28 percent for corporations). Capital assets generally include any property held by the taxpayer with the exception of property used, or held for sale, in the taxpayer's trade or business. This reduction in tax is treated as a preference item for purposes of the noncorporate and corporate minimum taxes.

Industrial development bonds

Although interest on State or local bonds used to finance trade or business activity (industrial development bonds) is generally taxable, various exceptions are provided, including, until December 31, 1986, bonds issued in certain "small issues." Property financed with IDBs generally is allowed cost recovery deductions at a slower rate than those otherwise allowed.

Treatment of losses on certain small business stock

Under present law, if an individual incurs a loss on certain small business stock, the loss is treated as an ordinary, rather than a capital, loss.

General stock ownership (GSOC) provisions

A GSOC is a domestic corporation that is chartered by an act of a State legislature or as a result of a statewide referendum. Shares in the corporation may be owned only by residents of the State. A GSOC is empowered to invest in properties, and 90 percent of its taxable income for any taxable year must be distributed to shareholders.

Employee ownership tax credit provisions

An employee stock ownership plan (ESOP) is a tax-qualified plan under which employer stock is held for the benefit of employees. The stock, which is held by a tax-exempt trust under the plan, may be acquired through direct employer contributions or with the proceeds of a loan to the trust. An employer who maintains an ESOP is permitted a deduction (within limits) for contributions to the plan. In addition, if the employer contributes additional cash or securities to an ESOP which qualifies as a tax credit ESOP, the employer may be entitled to an additional tax credit. No person other than the employer is allowed any deduction for ESOP contributions, and no other credit or deduction based on employee ownership is permitted to the employer.

Energy tax credit provisions

A tax credit of 15 percent is allowable for insulation and qualified energy conservation expenditures which include various

weatherproofing items, devices to improve efficiency of heating units, and energy conserving thermostats and meters.

A 40-percent tax credit is available for renewable energy sources which use solar, wind, geothermal or other renewable energy sources.

Both credits are available for expenditures through 1985 with respect to a dwelling unit in the United States that is the taxpayer's principal residence.

Energy investment tax credits, between 10 and 15 percent, are allowable for qualified expenditures through 1985, for solar, wind, ocean and geothermal property, certain hydroelectic generating property and intercity buses, and biomass property.

Foreign trade zones

A foreign trade zone may be established within any port of entry. For imported goods shipped into a zone, duties are not levied until and unless goods are sent into other United States territory.

Other provisions

Regulatory flexibility

Present law provides that certain regulatory procedures are to be followed in order to ease the regulatory burden on small businesses, small nonprofit organizations, or small governmental jurisdictions.

Small business loans

Direct loans may be made to small businesses from funds appropriated for these purposes. The loans may be direct or guaranteed, and made by agencies authorized to do so or by banks and other financial institutions. The loans may be made for the acquisition of land, structures and productive equipment.

Summary of H.R. 1955

Under H.R. 1955, businesses and employers located in an enterprise zone would be entitled to various tax incentives and special regulatory status, as summarized below.

Title I. Designation of enterprise zones

Enterprise zones would be designated by the Secretary of Housing and Urban Development after competitive review of State and local government nominations. Each nominated zone would have to satisfy various requirements concerning economic, demographic, and physical characteristics. The State and local governments seeking designation of a nominated area as an enterprise zone would be required to commit themselves to specific action to enhance the development of the area. The Secretary would be required to designate up to 75 areas as enterprise zones during the three-year period after enactment of the bill. A designation would remain in effect for 24 years, unless a shorter period were requested by the nominating governments or the Secretary revoked the designation.

Title II. Tax incentive provisions

Tax credit for zone employers

The bill would provide employers with a two-part nonrefundable tax credit. The first sort would be a credit equal to 10 percent of qualified wages in excess of the amount of qualified wages paid in the 12-month period before the area was designated as an enterprise zone, if earlier, or the date on which the enterprise zone was designated under State law, enacted after January 1, 1981. Qualified wages would be wages paid (subject to a limitation) to qualified employees, i.e., individuals 90 percent or more of whose services directly related to the zone business and 50 percent of whose services were performed in the zone. The second part of the credit would be available for a portion of wages paid, during the first 7 years of employment with each employer, to certain disadvantaged individuals who were also qualified employees.

Tax credit for zone employees

Qualified employees would be allowed a nonrefundable tax credit equal to 5 percent of earnings (up to 1½ times the dollar limit per employee on wages subject to FUTA).

Investment tax credit for zone property

An additional investment tax credit of 3 or 5 percent, depending on the type of property, would be allowed for personal property used in a trade or business in an enterprise zone. A 10-percent credit would be allowed for eligible real property. A basis adjustment would be required in both instances.

Elimination of capital gains taxation

The bill would eliminate taxes on all long-term capital gains resulting from the sale or exchange of property used in an enterprise zone in the active conduct of a trade or business, or from the sale or exchange of an interest in a qualified business. A qualified business would be a corporation, partnership or other entity at least 80 percent of the gross receipts of which were attributable to the active conduct of a trade or business (including rental of real estate) within an enterprise zone and substantially all the assets of which were located within a zone. Additionally, the bill would exclude enterprise zone capital gains from classification as tax preference items for purposes of the noncorporate and corporate minimum taxes.

Industrial development bonds

The December 31, 1986 termination of the "small issue" exception would be eliminated with respect to IDBs used to finance enterprise zone property and the provision restricting cost recovery deductions for property financed with IDBs would not apply with respect to enterprise zone property.

Tax simplification

The Internal Revenue Service would be required to simplify the administration of tax provisions added by this bill.

Title III. Regulatory flexibility

Upon request, Federal agencies and regulatory bodies could relax any regulatory requirements within zones, except requirements provided by statute including the Fair Labor Standards Act), or affecting civil rights, safety and public health.

Qualified businesses, any government nominating an area subsequently designated as an enterprise zone, and any not-for-profit enterprise operating within a zone would be accorded the same treatment under the Regulatory Flexibility Act as to now given to certain small entities.

Title IV. Foreign trade zones

Whenever possible, foreign trade zones could be established within enterprise zones.

Summary of H.R. 1735

Title I. Designation of revitalization areas

Revitalization areas would be designated by the Secretary of Housing and Urban Development after competitive review of State or local government nominations. Each nominated area would have to satisfy various criteria relating to economic, demographic and physical characteristics. A participating local government would be required to submit and follow a plan that specifies commitments to be made for the development of an area. The Secretary could designate revitalization areas during the 10-year period 1984–1993 and would be required to designate 205 areas according to a specified schedule during 1984–1988. A designation would remain in effect for 20 years, unless revoked by the Secretary.

Title II. Tax incentives

Revitalization area business

The bill would provide special tax incentives relating to revitalization area businesses. A revitalization area business would be defined as a business at least 50 percent of whose gross receipts are attributable to activities in a revitalization area and at least 30 percent of whose newly hired employees are qualified employees. qualified employees would include individuals performing at least 50 percent of their services within a revitalization area and meeting various alternative standards of need. Special provisions would require that a business increase its overall activity in economically distressed areas to qualify as a revitalization area business.

Employee ownership tax credit

Revitalization area businesses, stock of which was owned by or in behalf of at least 70 percent of the corporation's employees (qualfied corporations), could elect to claim a nonrefundable tax credit base on the amount of actual employee ownership. In general, the credit would be limited to the lesser of (1) the amount of the corporation's income tax liability reduced by certain other nonrefundable tax credits, or (2) $50,000.

Nonrecognition of gain on certain sales of stock to employees

No gain would be recognized on certain sales or exchanges of stock in revitalization area businesses by an individual to or with (1) leveraged ESOPs or tax credit ESOPs which invest primarily in stock issued by the revitalization area business and which meet certain nondiscrimination requirements; and (2) those revitalization area businesses which are producer cooperatives.

Rollover of gain reinvested in qualified property

The bill would provide for nonrecognition, or rollover, of gain on the sale or exchange of property if, within a specified period, the taxpayer purchased real or tangible personal property used or located in a revitalization area or an interest in a small revitalization area business (qualified property). The rule would apply only to the extent that the cost of the qualified property equalled or exceeded the amount of gain realized from the sale or exchange. The taxpayer's basis for the qualified property would be reduced by the amount of unrecognized gain.

Investment credit for low-income housing

An investment tax credit would be allowed for low-income rental housing located in a revitalization area.

Investment tax credit for entrepreneurial development centers

An investment tax credit would be allowed for establishing entrepreneurial development centers in a revitalization area.

Credit for employment of qualified employees

The bill would provide a revitalization area business with an elective tax credit equal to a percentage of qualified compensation paid to all newly hired qualified employees. Qualified compensation, with respect to any particular employee, would be a percentage of compensation that varies according to how long the employee has been employed by the revitalization area business. The credit would begin at a rate 40 percent for compensation paid to employees who have been employed for less than one year, and would be fully phased out with respect to compensation paid to employees who have been employed for 4 years or more.

Deduction for purchase of stock in area business

An individual would be allowed to deduct an amount equal to the purchase price of small revitalization area business stock or debentures subject to a maximum of $10,000 ($20,000 for a joint return).

Small business direct loans

Fifty million dollars of funds appropriated for small business direct loans would be allocated to small business concerns located in revitalization areas.

Amendments to targeted job tax credit

The bill would make the targeted jobs tax credit permanent. In addition, the bill would increase the amount of wages on which the credit is computed to $10,000 per employee per year.

Title III. General stock ownership corporations (GSOCs)

GSOCs similar to those that may be established under present law could be established in revitalization areas, with some modifications of the requirements. Among these changes, a revitalization area GSOC would have the authority to invest in real estate within the revitalization area.

Title IV. Employee stock ownership plans

The bill would increase the allowable deduction limit for employer contributions to an ESOP from 25 percent of compensation to 50 percent of compensation, provided the increased contributions were applied to the repayment of principal amounts on loans incurred to acquire employer securities. In addition, the bill would permit an employer corporation to deduct certain dividends paid on employer securities held by an ESOP and would permit charitable deductions for purposes of the income, estate and gift taxes to certain individuals who contributed employer stock to an ESOP.

Title V. Energy provisions

Residential energy credits

The bill would increase the tax credit for energy conservation expenditures from 15 to 40 percent after 1983. After December 31, 1985, the tax credits for energy conservation expenditures and renewable energy sources (which would then both be at 40 percent under the bill) would be available only for a residence located in a revitalization area.

Business energy credit

The bill would increase the tax credit for any energy investment property currently eligible to 30 percent for the period January 1, 1984 through December 31, 2002, in the case of a revitalization area business.

Summary of H.R. 2375

Designation of job expansion areas and businesses

Job expansion areas would be designated by the Secretary of Commerce after review of local governmental nominations. Each area would have to satisfy various requirements concerning economic, demographic and physical characteristics. The Secretary would be required to designate 75 job expansion areas during the three-year period after enactment of the bill. A designation would remain in effect for 10 years.

A business would be a job expansion business if at least 50 percent of the hours worked by all employees of the business are provided by workers employed in a job expansion area and, generally, at least 50 percent of the hours worked by those so employed are provided by residents of a job expansion area.

Expensing and investment tax credit for depreciable property

For qualified job expansion businesses, the bill would expand the scope of the election to expense qualified property to permit the expensing of an additional $50,000 of property located in a job expansion area. In addition, for property located in a job expansion area, the bill would (1) provide a 10-percent investment credit for new buildings, (2) raise the used property limitation on the investment credit by $400,000, and (3) extend the 25-percent investment credit for rehabilitation expenditures to buildings at least 20 years old.

Limited refundability of investment tax credit

Up to $250,000 of investment credit attributable to property located in a job expansion area would be treated as a refundable credit.

Tax credit for ESOP contributions

The limitation on the credit for contributions to ESOPs would be increased to two percent of payroll for a qualified job expansion business.

Tax credit for job expansion area employers

The bill would provide employers with a two-part nonrefundable tax credit. The first part would be a credit equal to 10 percent of qualified wages in excess of the amount of qualified wages paid in the 12-month period before the area was designated as a job expansion area, or, if earlier, the date on which the area was designated under a State law enacted after January 1, 1981. Qualified wages would be wages paid (subject to a limitation) to qualified employees, i.e., individuals 90 percent or more of whose services directly related to the job expansion area business and 50 percent of whose services were performed in the job expansion area. The second part

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of the credit would be available for a portion of wages paid to certain displaced workers who were also qualified employees.

Tax credit for job expansion area employees

Qualified employees would be allowed a nonrefundable tax credit equal to 5 percent of earnings (up to 1 1/2 times the FUTA wage base).

Deduction for purchase of stock in job expansion area business

An individual would be allowed to deduct an amount equal to the purchase price of job expansion area business stock or debentures subject to a maximum of $20,000 ($40,000 for a joint return).

Development investment assistance

Appropriations would be authorized for a program of grants to State and local governments for implementing development projects and formulating development investment strategies in job expansion areas.

Small business loans

Loans from the Small Business Administration would be available for small qualified job expansion businesses, and incentives would be provided for loans to such businesses by small business investment corporations.

II. DESCRIPTION OF H.R. 1955

(THE ENTERPRISE ZONE EMPLOYMENT AND DEVELOPMENT ACT OF 1983)

A. REVENUE PROVISIONS

1. Designation of Enterprise Zones (Title I of the Bill)

Present Law

The Internal Revenue Code contains a provision which defines targeted areas for the purpose of promoting certain types of economic development within those areas. In section 103A, relating to mortgage subsidy bonds, some rules for issuance of mortgage subsidy bonds for targeted areas are not as restrictive as the generally applicable rules. These rules were enacted in the Mortgage Subsidy Bond Tax Act of 1980 (P.L. 96-499).

For purposes of mortgage subsidy bonds, a targeted area is either a qualified census tract or an area of chronic distress. A qualified census tract is a tract in which 70 percent or more of the families have income which is 80 percent or less of the statewide median income. Areas of chronic economic distress are to be designated by a State according to its standards, and the designation must be approved by the Secretaries of Treasury and Housing and Urban Development. In evaluating a State designation, the Secretaries must use as criteria (1) the condition of the housing stock, (2) the need for housing assistance as indicated by low per capita income, a high percentage of families in poverty, a high number of welfare recipients, and high unemployment rates, (3) the potential for designation to improve housing conditions in the area, and (4) the existence of a housing assistance plan which provides a displacement program and a public improvements and services program.

Several other provisions of the Code provide special tax treatment for specific areas. Section 4994(e) exempts crude oil produced in certain areas of Alaska from the windfall profit tax. Section 165(i) provides that any casualty loss attributable to a disaster in an area designated to receive Federal assistance under the Disaster Relief Act of 1974 may be deducted, at the taxpayer's election, for the taxable year before the disaster occurred. In addition, certain domestic corporations deriving income from Puerto Rico and possessions of the United States (e.g., Guam) are eligible for a tax credit that eliminates the U.S. tax on that income. To qualify for the credit, the corporation must derive 80 percent or more of its gross income for the three immediately preceding years from sources within Puerto Rico or a possession of the United States and it must derive at least 65 percent of its gross income for that period from the active conduct of a trade or business within those countries. If a corporation meets these requirements, it is allowed a

credit equal to the U.S. tax attributable to the corporation's trade or business related income derived from Puerto Rico or the possession.

Explanation of Provisions

The bill would amend the Internal Revenue Code to provide criteria for the designation of enterprise zones.

a. Definition of enterprise zone

An enterprise zone would be any area which is nominated as an enterprise zone by one or more local governments and the State or States in which it is located, and which is approved by the Secretary of Housing and Urban Development (Secretary) after consultation with the Secretaries of Agriculture, Commerce, Labor, and the Treasury, the Director of the Office of Management and Budget, and the Administrator of the Small Business Administration. In the case of an enterprise zone on an Indian reservation, the Secretary of the Interior also would have to be consulted.

The term State would include Puerto Rico, the Virgin Islands, Guam, American Samoa, the Northern Mariana Islands, and any other possession of the United States. The term local government would include any county, city, town, township, parish, village or other general purpose political subdivision of a State, any combination of these subdivisions that is recognized by the Secretary, and the District of Columbia. In the case of a nominated area on an Indian reservation, the reservation governing body, as determined by the Secretary of the Interior, would be deemed to be both the State and local government.

Before designating any area as an enterprise zone, the Secretary would have to promulgate regulations, after consultation with the above Federal officials, describing (1) the nomination procedures, (2) the size and population characteristics of an enterprise zone, and (3) the procedures for comparing nominated areas using the criteria specified below for evaluating commitments made by State and local governments and for establishing priorities to be applied in making designations.

The Secretary could designate enterprise zones only during a 36-month period that begins the first day of the first month after the effective date of the regulations. (The tax benefits described below would be effective no earlier than January 1, 1984.) No more than 75 enterprise zones could be designated during this period. At least one-third of the zones designated would have to be areas which are outside a standard metropolitan statistical area or which are within a jurisdiction or jurisdictions of local government that have a population of less than 50,000 and are found by the Secretary (after consultation with the Secretary of Commerce) to be rural.

The Secretary could not designate an area as an enterprise zone unless the local government and the State in which the nominated area is located have the authority to nominate, to make commitments with respect to the zone, and to assure that the commitments will be fulfilled. Nominations would have to be submitted in the form, and with the information, required in the Secretary's regulations. The Secretary also would have to determine that the in-

formation submitted with a nomination is reasonably accurate and that no portion of the nominated area was already included in an enterprise zone or an area nominated as an enterprise zone.

b. Period of effect of designation

Under the bill, any enterprise zone designation would remain in effect from the date of designation to the earliest of December 31 of the calendar year 24 years later, the date stipulated by the State and local governments in their nomination application, or the date the zone designation is revoked by the Secretary. The Secretary, after consulting with the same Federal officials who must be consulted in designating enterprise zones, could revoke a zone designation if he determined that the State or local government was not substantially complying with the required State or local government commitments (described in d, below).

c. Area requirements

The Secretary could designate an area nominated as an enterprise zone, only if it meets requirements concerning size, population, area boundaries, unemployment, poverty and other signs of economic distress. A description of these requirements follows:

a. The area must be within the jurisdiction of the local government seeking the designation and have a continuous boundary.

b. The most recent census must show that the area's population is at least 1,000 (4,000 if any part of the area, other than a rural area, is located in a metropolitan statistical area with 50,000 or more people) or the area must be entirely within an Indian reservation (as determined by the Secretary of the Interior).

c. The nominating governments must certify and the Secretary accept that the area is one of pervasive poverty, unemployment and general distress, and is located wholly within jurisdiction which meets the requirements for Federal assistance under section 119 of the Housing and Community Development Act of 1974, as in effect on the date of enactment.[1]

d. The nominating governments must certify and the Secretary accept that at least one of four additional requirements is satisfied: (1) the rate of unemployment, as determined by the appropriate available data, is at least 1½ times the national unemployment rate; (2) according to the most recent census data, each census tract in the area has a 20 percent or higher poverty rate (or each census county division, where not tracted); (3) at least 70 percent of the households living in the area have income below 80 percent of the median income of the households of the area within the jurisdiction of the local government which nominates the area (determined in the same manner as under section 119(b)(2) of the Housing and Community Development Act of 1974); or (4) the population of the area has decreased by 20 percent or more between 1970 and 1980, as determined from the most recent census available.

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[1] Section 119 establishes a program of urban development action grants (UDAG) to severely distressed cities and urban counties to alleviate physical and economic deterioration through reclamation of neighborhoods. The eligibility of a city, or area within a city, generally is based on some or all of the city's or area's poverty rate, age of housing stock growth in per capita income, growth in population, growth in retailing and manufacturing employment, unemployment rate, and income distribution (see Appendix for description of eligibility criteria).

d. Required State and local government commitments

Under the bill, no area would be designated as an enterprise zone unless the local government and the State in which it is located agreed in writing that, during any period that the area was an enterprise zone, these governments will follow a specified course of action designed to reduce the various burdens borne by employers or employees in the area.

This course of action could be implemented by the State and local governments and private nongovernmental entities, and could be funded from the proceeds of any Federal program. The course of action could include, but would not be limited to, (1) a reduction of tax rates or fees applying within the enterprise zone, (2) an increase in the level or efficiency of local services within the enterprise zone, particularly through experiments with the supply of these services by nongovernmental entities, (3) elimination, reduction or simplification of governmental requirements applying within the enterprise zone, and (4) program involvement by private entities, organizations, neighborhood associations and community groups, particularly those within the nominated area, including a commitment from these private entities to provide technical, financial or other assistance to, and jobs or job training for, employers, employees and residents of the area.

e. Priority of designation

The bill would provide criteria for the Secretary to use in choosing areas nominated to be enterprise zones. The Secretary would be required to give special preference to those nominated areas for which the strongest and highest quality contributions to a course of action (as described above) have been promised by the nominating governments, taking into account their fiscal ability to provide tax relief. The Secretary also would be required to give preference to nominated areas with the following characteristics: (1) strongest and highest quality contributions in addition to contributions under item d above; (2) most effective and enforceable guarantees provided by nominating State and local governments that proposed courses of action actually would be carried out for the duration of the designation; (3) high levels of poverty, unemployment and general distress, particularly areas near concentrations of disadvantaged workers or long-term unemployed individuals for whom employment would be a strong likelihood if the area were designated an enterprise zone, (4) zone size and location that would primarily stimulate new economic activity and minimize unnecessary Federal tax losses; (5) most substantial commitments by private entities of additional resources and contributions, including creation of new or expanded business activities; and (6) nominated zones which best exhibit such other factors, to be determined by the Secretary, that would be consistent with the program's intent and important in minimizing unnecessary loss of Federal tax revenues.

f. Evaluation and reporting requirements

The Secretary of Housing and Urban Development would be required to prepare and submit to Congress a report on the effects of designating qualifying areas as enterprise zones in accomplishing the purposes of the legislation. The first report would be submitted not later than the close of the fourth calendar year after the year in which areas are first designated as enterprise zones. Subsequent reports would be submitted at four year intervals.

2. Tax Incentive Provisions (Title II of the Bill)

a. Tax credit for zone employers

Present Law

Overview

Under present law, there are no provisions under which an employer's Federal income tax liability varies according to the location of its employees or its change in employment. However, a provision in effect in recent years did provide a credit which varied with an employer's increased employment. In addition, the present law targeted jobs tax credit provides tax incentives for hiring specific groups of individuals.

Credit for increased employment (new jobs tax credit)

The Tax Reduction and Simplification Act of 1977 provided a new jobs tax credit for 1977 and 1978. The credit was 50 percent of the increase in each employer's wage base under the Federal Unemployment Tax Act (FUTA) above 102 percent of that wage base in the previous year. The FUTA base for 1977 consisted of wages paid of up to $4,200 per employee. The employer's deduction for wages was reduced by the amount of credit.

The total amount of the credit had four limitations: (1) the credit could not be more than 50 percent of the increase in total wages paid by the employer for the year above 105 percent of total wages paid by the employer in the previous year, (2) the credit could be not more than 25 percent of the current year's FUTA wages, (3) the credit for a year could not exceed $100,000, and (4) the credit could not exceed the taxpayer's tax liability. Credits which exceeded tax liability for a year could be carried back for 3 years and carried forward for 7 years.

Although most employers were able to use the returns they filed for purposes of complying with FUTA as a basis for claiming the credit, special rules were provided for businesses, such as farms and railroads, not covered under FUTA. Special rules also were provided for computation of the credit by groups of companies under common control, for businesses with employees working abroad, and for businesses affected by acquisitions, dispositions, and other changes in business form. Additional rules were provided for allocating the credit among members of a partnership and of a subchapter S corporation.

Targeted jobs tax credit

The targeted jobs tax credit, which applies to wages paid to eligible individuals who begin work for the employer before January 1, 1985, is available on an elective basis for hiring individuals from one or more of 9 target groups. The target groups are (1) vocational

rehabilitation referrals; (2) economically disadvantaged youths aged 18 through 24, (3) economically disadvantaged Vietnam-era veterans; (4) Supplemental Security Income (SSI) recipients; (5) general assistance recipients; (6) economically disadvantaged cooperative education students; (7) economically disadvantaged former convicts; (8) AFDC recipients and WIN registrants; and (9) disadvantaged youths aged 16 or 17 for summer employment.

The credit generally is equal to 50 percent of the first $6,000 of qualified first-year wages and 25 percent of qualified second-year wages paid to a member of a targeted group. Thus, the maximum credit is $3,000 per individual in the first year of employment and $1,500 per individual in the second year of employment. With respect to summer youth employment, however, the credit is 85 percent of up to $3,000 of wages, for a maximum credit of $2,550. The employer's deduction for wages, however, must be reduced by the amount of the credit.

The credit is subject to several limitations. For example, wages may be taken into account for purposes of the credit only if more than one-half of the wages paid during the taxable year to an employee are for services in the employer's trade or business. In addition, wages for purposes of the credit do not include amounts paid to an individual for whom the employer is receiving payments for on-the-job training under a Federally-funded program.

For purposes of determining the years of employment of an employee and whether the $6,000 cap has been reached with respect to any employee, all employees of any corporation that are members of a controlled group of corporations are treated as if they are employees of a single corporation. Under the controlled group rules, the amount of credit allowed to the group is generally the same which would be allowed if the group were a single company. Comparable rules are provided for partnerships, proprietorships, and other trades or businesses (whether or not incorporated) under common control.

The credit may not exceed 90 percent of the employeer's tax liability after being reduced by other nonrefundable credits. Excess credits may be carried back three years and carried forward fifteen years.

Explanation of Provision

In general

Under the bill, enterprise zone employers would be eligible to claim a tax credit equal to the sum of two parts—(1) an amount based on the increase in annual wages paid to employees working in the zone relative to wages paid to area employees in the period immediately before the area was designated as an enterprise zone, and (2) an amount based on wages paid in the current period to disadvantaged individuals working in the zone. The credit would be limited to the taxpayer's tax liability, and unused credit amounts could be carried back for 3 years or carried forward for the longer of 15 years or the remainder of the period during which the enterprise zone designation is in effect.

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Qualified wages and qualified employees

The computation of the credit would be based on a definition of qualified wages paid to qualified employees.

Under the bill, a qualified employee would be any employee 90 percent or more of whose services directly relate to the conduct of the employer's trade or business located in an enterprise zone and who performs at least 50 percent of his service for the employer in an enterprise zone. A qualified employee would not include an employee with respect to whom the employer claims the targeted jobs credit.

Qualified wages generally would be defined to include amounts subject to FUTA (Federal Unemployment Tax Act), without regard to any dollar limit (currently $7,000 per year per employee). Special rules similar to those used in the targeted jobs credit would provide for wages paid in connection with agricultural and railway labor not covered by FUTA. Qualified wages for any period would not include any amount of federally funded on-the-job training payments the employer receives or is entitled to receive with respect to a qualified employee for the period.

Increased enterprise zone employment

The first part of the credit would be equal to 10 percent of the excess of qualified wages paid or incurred during the taxable year to qualified employees in all enterprise zones over base period wages with respect to all zones. However, qualified wages could not be taken into account if they were taken into account in determining the amount of credit based on wages paid to economically disadvantaged individuals.

Base period wages, for any enterprise zone, would be the amount of wages which is paid during the 12-month period prior to zone designation, or, if earlier, the date on which the enterprise zone is designated under State law enacted after January 1, 1981, and which would have been qualified wages paid to individuals who would have been qualified employees if the designation had been in effect during this 12-month period. If the employer had no active trade or business in an area for which an enterprise zone designation was in effect for the taxable year for which the credit computation is made, base period wages for that enterprise zone would be zero.

Qualified wages taken into account for this portion of the credit could not exceed 2½ times the FUTA wage base in effect for the calendar year ending in the taxable year for which the credit computation is made. This limit would be used for the computation of base period wages as well as for the computation of current period qualified wages. If the FUTA wage base were increased, from one year to the next, then the amount of base period wages used in computing the credit in the second year would have to be recomputed to reflect the higher limit on the amount of wages per employee which could be taken into account.

The increased enterprise zone employment portion of the credit would be phased out starting in the taxable year of the taxpayer in which falls the twenty-first anniversary of the enterprise zone designation or, if earlier, the date 4 years before the date the zone des-

ignation was to expire. For this taxable year, the credit would be reduced to 7½ percent of qualified wages. The credit would then be reduced by 2½ percentage points for each succeeding year until fully terminated.

Disadvantaged individuals

The second part of the credit would be computed with respect to qualified wages paid to qualified employees who are also qualified disadvantaged individuals.

This portion of the credit would be allowable for a total of seven years with respect to any qualified employee. The credit would be 50 percent of qualified wages paid to a qualified economically disadvantaged individual for services performed during the 36-month period beginning the day the individual began work in an enterprise zone for an employer. The credit would then be reduced 10 percentage points during each of the succeeding twelve-month periods, to 40 percent of qualified wages attributable to services rendered in the fourth year, 30 percent of qualified wages attributable to services rendered in the fifth year, 20 percent of qualified wages attributable to services rendered in the sixth year, and 10 percent of qualified wages attributable to services rendered in the seventh year. The credit with respect to any one employee would not be available after the seventh year of employment. These time periods would not take into account any period of time during which the individual is unemployed or any period of time during which the individual is employed by a taxpayer in an enterprise zone designated under a State law enacted after January 1, 1981, if this designation occurred prior to the Federal designation.

A qualified disadvantaged individual would be anyone who is hired during the period an enterprise zone designation is in effect for the area in which the services which qualify the individual as a qualified employee are performed and who is either a member of an economically disadvantaged family or a general assistance or AFDC recipient as defined for purposes of the targeted jobs credit. Thus, in the first alternative, the individual would have to be certified by the designated local agency as being a member of a family that had an income, including the cash value of food stamps, during the 6 months immediately preceding the month in which the determination occurs, which, on an annual basis, is equal to or less than the combined Aid to Families with Dependent Children (AFDC) and food stamp benefits available to a family of the same size with no countable income or resoures. This combined benefit amount would be computed first by determining the highest amount which would ordinarily be paid under the AFDC program, in the State in which the family resides, to a family of the same size as the family being considered for tax credit eligibility. A family would not have to be of a type normally eligible for AFDC for the purposes of applying this standard. For example, the tax credit eligibility of a married couple with no children would be determined on the basis of the AFDC payment available to a single parent and one child, even though childless couples are not eligible for AFDC payments. Determinations throughout the entirety of each State would use the highest benefit amount available in any locality in the State to an assistance unit with no income and re-

sources and with maximum need. The food stamp portion of the combined benefit amount then would be computed by assuming that the household's only income consists of AFDC benefits in the amount just determined, that the household consists only of the AFDC unit for which the computation is made (e.g., that there are no unrelated individuals living in the household), and that the family is entitled to the standard deduction and the maximum amount of other deductions which ordinarily are allowed to a household, the income of which consists entirely of AFDC benefits.

Alternatively, to be eligible for this portion of the tax credit, the individual would have to be certified as having been placed in employment under a work incentive program, or as receiving assistance under either the AFDC program for the 90-day period preceding the hiring date or under a general assistance program for not less than 30 days ending within the 60-day period ending on the day the individual is hired by the employer. Only those general assistance programs designated by the Secretary of the Treasury as consisting of money, voucher, or scrip payments based on need would be taken into account for this purpose. The Secretary would not designate any program designed specifically by a State or local government for enterprise zone residents in order to determine eligibility for this credit.

The credit amount would be reduced 25 percent in the first year in which the increased employment credit begins to phase out. And this reduction factor would be increased by 25 percent each year until the credit is fully eliminated.

Other rules

Rules analogous to those contained in the present targeted jobs and research and experimental expenditures tax credits would control certification procedures and allocation and computation of the credit for controlled groups of businesses, for subchapter S corporations and their shareholders, for estate and trusts and their beneficiaries, and for employers affected by acquisitions and dispositions. Special rules also would be provided for taxpayers for which a zone designation is in effect only part of the taxable year or with a short taxable year.

Any credit taken with respect to an employee would be recaptured if the employee is terminated at any time during the first 270 days after the employee begins work for the employer, with certain exceptions, including voluntary termination, disability, or misconduct of the employees, or substantial reduction of the business. However, if the major portion of a trade or business, or the major portion of a separate unit of a trade or business of an employer were acquired by another employer, then employment of any qualified employee would not be terminated for purposes of this credit if the employee continued to be employed in that trade or business.

The amount of any deduction allowable to an enterprise zone employer for wages paid to employees would be reduced by the amount of credit allowable under this provision for the taxable year.

Effective Date

The provision would apply to taxable years beginning after December 31, 1983.

b. Tax credit for zone employees

Present Law

Under present law, the tax liability of an employee working in the United States generally does not vary according to the location of his employment. However, a refundable tax credit, the earned income credit, is allowed to certain low-income families with children.

Under the earned income credit provision, taxpayers living with children in the United States are eligible for a credit equal to 10 percent of the first $5,000 of earnings. The maximum credit is $500. The maximum credit is reduced by 12.5 percent of the taxpayer's adjusted gross income (or if greater, earned income) in excess of $6,000. Thus, no credit is available to taxpayers with incomes of $10,000 or more.

Explanation of Provision

Under the bill, qualified employees would be entitled to claim a nonrefundable tax credit equal to 5 percent of qualified wages for the taxable year. For purposes of this credit, qualified wages would be equal to all remuneration paid for services of a qualified employee, but not including any compensation received from the Federal Government or any State or subdivision of a State, up to 1½ times the wage base in effect for the purpose of the Federal Unemployment Tax Act (FUTA) (currently $7,000). Thus, the maximum credit for any taxable year until the FUTA base is changed would be 5 percent of $10,500 or $525.

For purposes of this credit, a qualified employee would be an individual at least 90 percent of whose services are directly related to an enterprise zone trade or business and at least 50 percent of whose services are performed in an enterprise zone, and who is not an employee of the Federal Government or any State or local subdivision of any State. The determination of whether an individual was a qualified employee would be made separately with respect to each of the individual's employers.

The credit would phase out starting in the taxable year of the employee in which fell the twenty-first anniversary of enterprise zone designation, or, if earlier, the date 4 years before the date the zone designation is to expire, and would be phased out completely in four years.

Effective Date

The provision would apply in taxable years after December 31, 1983.

c. Investment tax credit for zone property

Present Law

Under present law, a regular investment tax credit is allowed for investment in tangible personal property and other tangible property (generally not including buildings or structural components) used in connection with manufacturing, production, or certain other activities. For eligible property in the 3-year recovery class, a 6-percent regular investment tax credit is allowed. For other eligible property, a 10-percent regular investment tax credit is allowed.

Buildings and their structural components generally do not qualify for the regular investment tax credit. However, in the case of qualified rehabilitation expenditures, a 15-percent tax credit is allowed for nonresidential buildings at least 30 years old, a 20-percent tax credit is allowed for nonresidential buildings at least 40 years old, and a 25-percent tax credit is allowed for certified historic buildings. The rehabilitation credit is allowed only for property that otherwise is not eligible for the investment tax credit. Unused investment tax credits may be carried back 3 years and carried forward for 15 years.

The basis of the asset, for such purposes as capital cost recovery deductions, is reduced by the full amount of the 15-percent or 20-percent rehabilitation tax credit and by half the investment tax credit for other types of property.

Explanation of Provision

Under the bill, an additional investment tax credit would be allowed for certain capital investments in an enterprise zone.

Zone personal property

In the case of property eligible for the regular investment tax credit (other than elevators and escalators), an additional 3-percent credit would be available for 3-year recovery property, and an additional 5-percent credit would be available for 5-year property, 10-year property and 15-year public utility property. In order to be eligible for this additional credit, such property would have to be acquired and first placed in service by the taxpayer in an enterprise zone during the period the designation as a zone is in effect. The property would not have to be new property. The taxpayer would have to use the property predominantly in the active conduct of a trade or business within an enterprise zone and could not acquire the property from a related person. Property used or located outside the enterprise zone on a regular basis would not be eligible for the additional credit. The credit rate would be reduced by 25-percent in the first year in which the employment credit begins to be phased out, and by an additional 25-percent each year thereafter.

The basis of property eligible for this additional 3- or 5-percent credit would be reduced by half the amount of the additional credit allowable.

New zone construction property

An additional 10-percent tax credit would be available for 15-year real property (including lodging) located in an enterprise zone if the property is acquired or constructed by the taxpayer and used predominantly in the active conduct of a trade or business, including the rental of real estate, within the enterprise zone. In the case of property acquired by the taxpayer, the additional credit would be available only if the property was acquired after designation of the zone and only if the original use of the property commenced with the taxpayer. In the case of property constructed, reconstructed, rehabilitated. renovated, expanded, or erected by the taxpayer, the credit would be available only to the extent of any construction or erection after designation of the enterprise zone. The credit rate would be reduced by 25 percent in the first year in which the employment credit begins to be phased out, and by an additional 25 percent each year thereafter.

The basis of property eligible for this additional 10-percent tax credit would be reduced by the full amount of the additional credit allowable.

Recapture

If property for which an enterprise zone credit was claimed by a taxpayer ceases to be enterprise zone property of the taxpayer (other than by expiration or revocation of the designation of the zone), a portion of the enterprise zone credit would be recaptured. Property would cease to be enterprise zone property of a taxpayer if, for example, the taxpayer disposed of the property, removed the property from the enterprise zone, or ceased to use the property in the active conduct of a trade or business within the enterprise zone.

The amount of the enterprise zone credit subject to recapture would be the difference between the amount of credit allowed for the property and a recomputed credit based on the amount of time the property was enterprise zone property of the taxpayer. The recomputed credit would bear the same ratio to the amount of credit originally allowed as the number of taxable years in which the property was enterprise zone property of the taxpayer bears to the number of years over which the property is depreciated for purposes of computing earnings and profits. The recapture periods would be as follows:

	Years
3-year property	5
5-year property	12
10-year property	25
15-year public utility property	35
15-year real property	35

Thus, for example, no enterprise zone credit would be recaptured with respect to 3-year recovery property if it remained enterprise

zone property of the taxpayer for 5 taxable years. If this property had been enterprise zone property of the taxpayer for only 4 taxable years, 20 percent of the enterprise zone credit would be recaptured.

Carryover period

Unused investment tax credit amounts attributable to the additional enterprise zone percentage could be carried forward for the remaining life of the enterprise zone or 15 years, whichever is longer.

Effective Date

The provision generally would apply to periods after December 31, 1983.

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d. Elimination of capital gains taxation

Present Law

In general

Under present law, gain or loss from the sale or exchange of a capital asset receives special tax treatment. For this purpose, the term "capital asset" generally means any property held by the taxpayer. However, capital assets generally do not include (1) inventory, stock in trade, or property held primarily for sale to customers in the ordinary course of the taxpayer's trade or business, (2) depreciable or real property used in the taxpayer's trade or business, (3) specified literary or artistic property, (4) business accounts or notes receivable, or (5) certain U.S. publications. Although depreciable personal property and real property used in a trade or business are not capital assets, gains from sales or exchanges of those assets may be treated as capital gains under certain circumstances.

Noncorporate capital gains deduction

Noncorporate taxpayers may deduct from gross income 60 percent of the amount of any net capital gain (the excess of net long-term capital gain over net short-term capital loss) for the taxable year. (Long-term capital gain is defined as gain from the sale or exchange of a capital asset held for more than one year). The remaining 40 percent of the net capital gain is included in gross income and taxed at the otherwise applicable regular income tax rates. As a result, the highest tax rate applicable to a noncorporate taxpayer's entire net capital gain is 20 percent, i.e., 50 percent (the highest individual tax rate) times the 40 percent of the entire net capital gain includible in adjusted gross income.

Corporate capital gains tax

An alternative tax rate of 28 percent applies to a corporation's net capital gain (the excess of net long-term capital gain over net short-term capital loss) if the tax computed using that rate is lower than the corporation's regular tax. (The highest regular corporate tax rate is 46 percent for taxable income over $100,000.)

Minimum taxes

"Add-on" minimum tax

Present law imposes an "add-on" minimum tax for corporations on certain tax preference items. 18¾6ths of a corporation's net capital gain is a tax preference subject to the minimum tax.

Alternative minimum tax

Under present law, noncorporate taxpayers are subject to an alternative minimum tax to the extent that it exceeds their regular income tax. The alternative minimum tax is based on the taxpayer's adjusted gross income, as reduced by allowed deductions, and increased by tax preference items, including the 60 percent of net capital gains deducted in computing the regular tax. The alternative minimum tax rate is 20 percent for amounts in excess of a specified exemption amount.

Explanation of Provision

The bill would eliminate taxes on long-term capital gains resulting from the sale or exchange of (1) property used in an enterprise zone in the active conduct of a trade or business or (2) an interest in an enterprise zone "qualified business." Additionally, the bill would exclude enterprise zone capital gains from classification as tax preference items for purposes of the noncorporate and corporate minimum taxes.

Qualified property and qualified business

The bill would eliminate tax on gain from sales or exchanges of "qualified property" otherwise eligible for long-term capital gain treatment. For this purpose, the term "qualified property" would mean (1) tangible personal property used predominantly by the taxpayer in an enterprise zone in the active conduct of a trade or business in a zone, (2) real property located in an enterprise zone and which is used predominantly by the taxpayer in the active conduct of a trade or business in a zone and (3) an interest in a corporation, partnership, or other entity if, for the three most recent taxable years of the entity ending before the date of disposition of the interest, the entity was a "qualified business."

Under the provision, the term "qualified business" would mean any person (1) actively engaged in the conduct of a trade or business (including rental of real estate) during the three most recent taxable years, (2) at least 80 percent of the gross receipts of which for the taxable year are attributable to the active conduct of a trade or business within an enterprise zone, and (3) substantially all of the tangible assets of which are located within an enterprise zone.

Under the bill, gain from the sale or exchange of an interest in a qualified business would not be treated as gain from the sale or exchange of qualified property to the extent the gain was attributable to (1) any property contributed to the qualified business within the previous 12 months, (2) any interest in a business which is not a qualified business, (3) any gain allocable to a period when the property is not qualified property, or (4) any other intangible property not properly allocable to an active trade or business within an enterprise zone.

Under the bill, the special tax treatment for gain from sales or exchanges of qualified property would not cease to be available upon the termination or revocation of an area's designation as an enterprise zone. However, the treatment would not apply after the

first sale or exchange of any item of qualified property after the designation ceases to apply.

Noncorporate capital gains deduction

The bill would allow a noncorporate taxpayer to deduct from gross income 100 percent of any long-term capital gain from qualified property.

Corporate capital gains tax

The bill would allow a corporation to exclude from taxation all long-term capital gain from qualified property.

Tax preferences for minimum tax purposes

The bill would eliminate net capital gains attributable to qualified property from classification as a tax preference item for purposes of the corporate and noncorporate minimum taxes.

Effective Date

The provision would be effective for sales or exchanges after December 31, 1983.

e. Industrial development bonds

Present Law

Interest on State and local government obligations generally is exempt from Federal income tax (obligations issued after June 30, 1983, must be in registered form to be exempt). However, subject to certain exceptions, interest on State and local issue of industrial development bonds is taxable. An obligation constitutes an industrial development bond (IDB) if (1) all or a major portion of the proceeds of the issue are to be used in any trade or business of a person other than a governmental unit or tax-exempt organization described in sec. 501(c)(3) and (2) payment of principal or interest on the obligation is secured by an interest in, or derived from payments with respect to, property or borrowed money used, or to be used, in a trade or business.

Present law provides an exception which exempts from tax interest on IDBs that are issued to finance the following types of exempt activities: (1) projects for low-income residential rental property, (2) sports facilities, (3) convention or trade show facilities, (4) airports, docks, wharves, mass commuting facilities, and parking facilities, (5) sewage and solid waste disposal facilities, and facilities for the local furnishing of electricity or gas, (6) air or water pollution control facilities, (7) certain facilities for the furnishing of water, (8) qualified hydroelectric generating facilities, and (9) qualified mass commuting vehicles. In addition, the interest on certain IDBs issued for the purpose of acquiring or developing land as a site for an industrial park is exempt from taxation.

Present law also provides an exception for certain "small issues" to the general rule of taxability of interest paid on industrial development bonds. This exception is not available for bond proceeds used for golf courses, country clubs, racetracks and other specified types of facilities. This exception applies to issues of $1 million or less if the proceeds are used for the acquisition, construction, or improvement of land or depreciable property.

At the election of the issuer, the $1 million limitation may be increased to $10 million. If the election is made, the exception is restricted to projects where the aggregate amount of outstanding exempt small issues and capital expenditures (financed otherwise than out of the proceeds of exempt small issues) made over a six-year period does not exceed $10 million. Both the $1 million and $10 million limitations are determined by aggregating the face amount of all outstanding related issues, plus, in the case of the $10 million limitation, certain capital expenditures for all facilities used by the same or related principal users which are located within the same county or same incorporated municipality.

In general, the small issue exemption will not apply with respect to obligations issued after December 31, 1986.

Under present law, to the extent that certain facilities are financed by an IDB and the property is placed in service after December 31, 1982, such property generally is allowed cost recovery deductions at a slower rate than those allowed under ACRS or other accelerated cost recovery provisions of the Code. In lieu of deductions under ACRS, the cost of property financed with IDSs must be recovered using the straight-line method over the ARCS life for the property involved. This limitation applies to both the first owner of the property and to any subsequent owners who acquire the property while the IDBs (including any refunding issues) are outstanding.

However, the cost of the following types of facilities financed in whole or in part with IDBs may continue to be recovered under ACRS: low-income rental housing, municipal sewage and solid waste disposal facilities, air or water pollution control facilities used in connection with a plant or other property in operation before July 1, 1982, and facilities for which a UDAG grant equaling or exceeding 5 percent of the total capital expenditures on the facility is made.[1]

Explanation of Provision

The bill provides that the provision of present law which restricts the cost recovery deductions for property financed with tax-exempt bonds would not apply to enterprise zone property eligible for the additional investment credit described above (item II.A.2.c.)

The bill also provides that the provision of present law which teminates the small issue exception after December 31, 1986, would not apply to any obligation which is part of an issue substantially all of the proceeds of which are used to finance facilities placed in service in an area for which an enterprise zone designation is in effect.

Effective Date

The provisions would apply to obligations issued after December 31, 1983 in taxable years ending after such date.

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[1] On October 21, 1983, the Committee on Ways and Means reported H.R. 4170 (Rept. No. 98-432), 98th Cong. 1st Sess). Portions of H.R. 4170 would (1) place a $150 per capita volume limitation on the amount of industrial development bonds and student loan bonds that States and localities could issue, (2) preclude the use of industrial development bonds to acquire certain land and existing structures, (3) prevent the issuance of tax-exempt bonds which are Federally guaranteed, (4) prevent the use of small issue industrial development bonds where the user would have more than $40 million of outstanding tax-exempt financing, (5) prevent the use of industrial development bonds for certain purposes, and (6) remove the exceptions for pollution control facilities, municipal sewerage and solid waste disposal facilities, and UDAG facilities from the rule requiring recovery of IDB financed property on a straight line method over ACRS lives.

f. Tax simplification

Present Law

In the past, the tax law has imposed various simplification requirements. For example, the Tax Reform Act of 1976 required the Joint Committee on Taxation to conduct a study of simplification of the tax law.[1] In addition, the Revenue Act of 1978 required the Treasury Department to conduct a study of simplification of income tax forms and instructions.[2]

Under present law, one of the duties of the Joint Committee on Taxation is to investigate measures and methods for the simplification of the tax laws (Code sec. 8022(2)).[3]

Explanation of Provision

The bill would provide that it is the sense of the Congress that the Internal Revenue Service should, in every way possible, simplify the administration and enforcement of the tax provisions added to the Internal Revenue Code by this bill.

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[1] Sec. 507 of P.L. 94-455. The report, *Issues in Simplification of the Income Tax Laws*, was submitted in September 1977.

[2] Sec. 551 of P.L. 95-600.

[3] For example, at the request of the Joint Committee, the U.S. General Accounting Office conducted a study on simplification of income tax forms and issued a report entitled *Further Simplification of Income Tax Forms and Instructions Is Needed and Possible* (GAO Report No. GGD-78-74; July 5 1978). The General Accounting Office has conducted numerous other tax administration studies in recent years for the Joint Committee and other congressional committees.

3. Establishment of Foreign Trade Zones in Enterprise Zones (Title IV of the Bill)

Present Law

Foreign trade zones are secure areas under U.S. Customs supervision that are considered outside the U.S. Customs Territory. Each port of entry is entitled to at least one foreign trade zone. In a foreign trade zone, foreign and domestic merchandise may be stored, sold, repaired, assembled, distributed, manufactured and displayed within the zone, and then exported or sent into the U.S. Customs Territory. Only when sent into Customs territory for domestic consumption do the goods become subject to the laws affecting imported merchandise, such as the levy of customs duties. The importer has the choice of paying duties on the original foreign materials or on the finished product. Domestic goods moved into the zone for export are considered exported upon entry into the zone for purposes of excise tax rebates and duty drawback.

Foreign trade zones are authorized by the Foreign Trade Zone Board, a Federal agency chaired by the Secretary of Commerce. Such zones typically consist arehouses, or industrial parks.

Explanation of Provision

The bill would require the Foreign Trade Zone Board to expedite on a priority basis the processing and approval, to the maximum extent practicable, of any application involving the establishment of a foreign trade zone within an enterprise zone. The Secretary of the Treasury would be required to give the same urgent consideration to an application for establishment of a port of entry necessary to permit the establishment of a foreign trade zone within an enterprise zone. These requirements would be in force, however, following such designation.

B. OTHER PROVISIONS

1. Interaction With Other Federal Programs

a. General revenue sharing

Present Law

The general revenue sharing program, as authorized by the State and Local Fiscal Assistance Amendments of 1980 (P.L. 96-604), provides payments to local governments, on an entitlement basis, of $4.6 billion in both fiscal year 1982 and fiscal year 1983. Payments to State governments are authorized for these years, but are limited to the amount of categorical grant assistance that a State returns to the Federal Government. No funds have been appropriated under these State government authorizations and no regulations have been issued establishing procedures for returning grant funds to the Federal Government. Subject to few restrictions, State and local governments may use the funds for any purpose they deem appropriate.

The allocation of funds among State and local governments under the general revenue sharing program is determined under formulas which take into account several characteristics of the areas. These include population, urbanized population, per capita income, education spending, intergovernmental transfers, income tax collections, and total tax collections.

Explanation of Provision

Any reduction of taxes under any required program of local commitment under the enterprise zone program would be disregarded in determining the eligibility of a State of local government for, or the amount or extent of, any assistance or benefits under any law of the United States.

b. Uniform Relocation Assistance and Real Property Acquisition Policies Act of 1970

Present Law

The Uniform Relocation Assistance and Real Property Acquisition Policies Act of 1970 (P.L. 91-646) governs the responsibilities of Federal agencies which displace residents, businesses and farms because of an acquisition of real property or a requirement that property be vacated which is attributable to Federal or federally assisted projects or programs. Various forms of relocation assistance are provided under the Act. This assistance includes moving expenses, reimbursement of business losses, advisory services, and partial payments for or, under certain circumstances, actual provision of, replacement housing.

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Explanation of Provision

Designation of an enterprise zone would not constitute approval of a Federal or Federally assisted program or project as those terms are used in the Uniform Relocation Assistance and Real Property Acquisition Policies Act of 1970. No person displaced from real property located in an area designated as an enterprise zone would have any rights or be entitled to any benefit pursuant to that Act as a result of such legislation.

c. National Environmental Policy Act

Present Law

Under the National Environmental Policy Act, environmental assessments, and, if necessary, impact statements must be prepared with respect to certain Federal actions. These statements must include assessments of adverse environmental effects of proposed actions and, where appropriate, possible alternatives to these actions. Similar procedural requirements are required under other Federal environmental laws.

Explanation of Provision

Designation of an area as an enterprise zone would not constitute a Federal action for the purposes of applying the requirements of the National Environmental Policy Act or other provisions of Federal law relating to the protection of the environment. As a result, none of the Federal procedural requirements relating to environmental impact statements need to be met on account of the designation of an enterprise zone. These requirements would be in force, however, following such designation.

2. Regulatory Flexibility (Title III of the Bill)

Present Law

The Regulatory Flexibility Act (5 USC secs. 602–612) requires Federal regulatory agencies to publish analyses of the economic impact on entities under its coverage of any proposed regulations and to discuss alternatives to those regulations. The Act requires Federal regulatory agencies to undertake a periodic review of their regulations to determine whether they should be changed to minimize their economic impact on the entities covered by the Act.

In general, the purpose of the Regulatory Flexibility Act is to require Federal agencies to fit regulatory and informational requirements to the scale of the businesses, organizations, and governmental jurisdictions subject to regulation. To achieve this goal, agencies are required to solicit and consider flexible regulatory proposals and to explain the rationale for their actions to assure that such proposals are given serious consideration. The act requires that special attention is to be given to small entities. For example, in its initial regulatory flexibility analysis, an agency must decribe the impact of a proposed rule on small entities.

Small entities, for purposes of the Regulatory Flexibility Act, are small businesses (generally independently owned and operated business enterprises that are not dominant in their fields of operation), small organizations (independently owned and operated not-for-profit enterprises that are not dominant in their fields), and small governmental jurisdictions (governments of cities, towns, townships, villages, school districts, or special districts, with populations of less than fifty thousand).

Explanation of Provisions

Designation of zone entities of small entities for purposes of analysis of regulatory functions

The bill would expand the definition of a small entity, for purposes of the Regulatory Flexibility Act, to include any qualified zone business, any government designating an area as an enterprise zone to the extent any regulatory rule would affect the zone, and any not-for-profit enterpirse operating within an enterprise zone.

Waiver or modification of agency rules in enterprise zones

Under the bill, Federal agencies and regulatory bodies would be given discretionary authority to relax or eliminate any regulatory requirements within enterprise zones except those affecting civil rights, safety and public health, or those required by statute, including any requirement of the Fair Labor Standards Act. This authority could be exercised only upon request of State and local gov-

ernments.[1] Agencies would make their determinations on requests not later than 90 days after their receipt. Such waivers or determinations would not be considered a rule, rulemaking, or regulation under the Administrative Procedure Act.

Coordination of Housing and Urban Development Programs in enterprise zones

The bill would provide that the Secretary of Housing and Urban Development would be required to promote the coordination of programs under his jurisdiction and carried on in an enterprise zone and to consolidate requirements for related applications and reports required under these programs.

[1] Examples of regulations which could be relaxed include regulations governing exports, regulations affecting accounting treatment of loans made by national banks, regulations affecting inventory accounting for tax purposes, regulations affecting issuance of securities, and regulation affecting various energy performance, coal conversion, and conservation regulations.

C. Revenue Effects of the Bill

The effect of H.R. 1955 on budget receipts will depend on the number, size, and characteristics of the zones designated by the Secretary of Housing and Urban Development. Because the bill provides the Secretary with wide latitude in his choice, it is extremely difficult to provide specific cost estimates for these provisions.

The Treasury Department estimates that these provisions will reduce fiscal year receipts by $0.1 billion in 1984, $0.4 billion in 1985, $0.7 billion in 1986, $0.9 billion in 1987 and $1.0 billion in 1988. These estimates are based on particular assumptions about the size and characteristics of the zones. However, these assumptions are not mandated by the provisions of this bill, and, thus, these figures may either underestimate or overestimate the actual revenue loss by a considerable degree.

Treasury's estimates are based on the assumption that the zones selected by the Secretary of Housing and Urban Development would have, at the time of designation, average employment, other than in governments and non-profit institutions, of approximately 6,700 persons and a mix of economic activities similar to those of a sample of distressed areas in several cities. The language of the bill does not require this average employment and economic mix, however, so that the above figures may not estimate the actual revenue loss. If the average zone has, for example, only 3,500 employees, then actual revenue losses would be $0.05 billion, $0.2 billion, $0.4 billion, $0.5 billion, and $0.5 billion in fiscal years 1984 through 1988, respectively, if the assumptions about the economic mix were correct.

On the other hand, several factors could make the actual revenue loss higher than the Treasury estimates. First, the actual mix of economic activities in the zone or attracted to the zone could be very payroll intensive and have a high ratio of investment to payroll, substantially increasing the cost of the tax incentives relative to what was assumed.

Second, the Treasury estimate assumes designation of the 75 zones ratably over the 1984–1986 period. If a higher proportion of the zones were designated in the earlier portion of this period, the revenue loss would be larger in all the above years.

Third, because of data limitations, the Treasury estimates do not take into account losses associated with investments by public utilities.

Fourth, the average size of zones when they are actually designated by the Secretary could be much larger than an average taxable employment of 6,700. If, for example, employment in designat-

ed zones were to average 35,000 and the economic mix were the same as assumed by Treasury, fiscal year revenue losses would be $0.5 billion in 1984, $2.1 billion in 1985, $3.8 billion in 1986, $4.9 billion in 1987 and $5.1 billion in 1988.

D. Prior Congressional Action

§ 1983 congressional action

In May 1983, the Senate Committee on Finance approved an amendment similar to the provisions of H.R. 1955, which was included in the Finance Committee amendment to H.R. 2973, as passed by the Senate on June 16, 1983.[1] The Senate amendment to H.R. 2973 relating to enterprise zone tax incentives was deleted in conference on the bill.

§ 1982 congressional action

In 1982 the Senate Committee on Finance reported provisions relating to enterprise zone tax incentives as an amendment to H.R. 7094.[2] This bill was not passed by the Senate in the 97th Congress.

[1] The Finance Committee printed an "Explanation of Committee Amendment to H.R. 2973" on June 8, 1983 (Sen. Print 98-58).

[2] See Sen. Rep. No. 97-662, October 18, 1982.

III. DESCRIPTION OF H.R. 1735

(THE COMMUNITY ASSISTANCE AND REVITALIZATION ACT OF 1983)

A. REVENUE PROVISIONS

1. Designation of Revitalization Areas (Title I of the Bill)

Present Law

The Internal Revenue Code contains several provisions which provide special tax treatment in specific geographic areas. (See description in item II.A.1., above.)

Explanation of Provisions

This title of the bill would provide rules for the designation of revitalization areas.

a. Definition of revitalization areas

A revitalization area would be any area in the United States or its possessions that is nominated by the appropriate State government and designated a revitalization area by the Secretary of Housing and Urban Development (Secretary), after consultation with the Administrator of the Small Business Administration and the Secretaries of Commerce, Labor and the Treasury. A local government could nominate an area if its State government fails to nominate within 60 days after a request to do so.

The Secretary would be required to prescribe regulations, not later than 180 days after the date of enactment, providing the form, manner and schedules for filing applications.

The Secretary could designate revitalization areas at any time after 1983 and before 1994, and would be required to designate 30 areas in 1984, 30 in 1985, 35 in 1986, 45 in 1987, and 65 in 1988.

b. Period of effect of designation

In general, a revitalization area designation would remain in effect for the 20-year period which begins on the date of designation. However, the Secretary, after consulting the same Federal officials who must be consulted in designating revitalization areas and providing the opportunity of a hearing for the participating local government, could revoke a designation at an earlier date, if he determined that the local government was not substantially complying with its revitalization area development plan (described below).

c. Areas and development plan requirements for preliminary approval

The Secretary could not give final approval of a designation without having first given preliminary approval. This preliminary approval could be given only if the area meets certain requirements and the participating local government submits a revitalization area development plan, has established a revitalization area management authority and has consulted residents and organizations located in the area.

A description of the area requirements follows:

(1) The area must be within the jurisdiction of the participating local government, have a continuous boundary that includes, if feasible, proximately located vacant or underutilized land or buildings conveniently accessible to area residents, and comprise at least 1 square mile.

(2) The most recent census must show that the area's population is at least 2,500 (4,000 if any part is located in a standard metropolitan statistical area with 50,000 or more people) or the area must be an Indian reservation (as determined by the Secretary of the Interior).

(3) The Secretary must determine that the area is one of pervasive poverty, unemployment and general distress.

(4) At least one of four additional requirements must be satisfied: (a) the average rate of unemployment in the area for the most recent 18 months is at least 1½ times the nationwide rate; (b) the area is a low-income poverty area, as determined by the most recent census; (c) at least 60 percent of the area's residents have incomes below 80 percent of the median income of residents of the participating local government (determined as under section 119(b) of the Housing and Community Development Act of 1974); or (d) aggregate population in census tracts in the area decreased by 10 percent or more between 1970 and 1980 and chronic abandonment, demolition or substantial tax arrearages of structures exists in the area.

The revitalization area development plan would assess conditions, specify and assign priority to development objectives, provide for a revitalization area management authority and specify its powers, and provide advisory guidelines for the making and evaluating of investment and development decisions. The plan would specify how residents' equity ownership of property would be affected by development, evaluate aspects of the labor market (including job, entrepreneurial and managerial resources) in the area and specify any commitments to assist in meeting the needs of residents and businesses. In addition, the plan would evaluate the needs, resources and potential of small, minority, and ownership-expanding businesses in the area and specify any commitments to be made by State and local governments or others to assist in meeting the needs of these businesses. (In general, an ownership-expanding business would mean a revitalization area business which is a producer cooperative or has an employee stock ownership plan, whose nonmanagerial employees own at least a 35-percent interest in the business, and which annually distributes as bonuses at least 10 percent of its profits to its employees.) The plan also would

evaluate the status of efforts and provide commitments to improve energy efficiency in the area. Furthermore, the plan would specify any commitment, among others, to limit residential displacement and related problems, to have at least 10 percent of the proceeds of industrial development bonds issued during a year by a participating local government be used by revitalization area businesses (especially small, minority, or ownership-expanding businesses) to assist entrepreneurship of minorities and youths, to maintain and increase the availability of low-income and moderate-income housing, to streamline government regulations not directly related to health and safety, to improve public services, to reduce local government fees, taxes or other expenses for businesses located in the area, and to use, as much as practicable, revitalization area businesses to provide public services within the area.

d. Requirements for final approval

The Secretary could give final approval to the designation of an area as a revitalization area only if he had given it preliminary approval and found that the participating local government had taken adequate measures for fulfilling the commitments made in the revitalization area development plan.

e. Priority of designation

In choosing the areas to designate, the Secretary would be required to give preference to areas with the highest levels of general distress and with respect to which the participating local government demonstrates the most comprehensive and determined commitment to pursue its revitalization area redevelopment plan (judged in part by the breadth of support among residents and various organizations). In addition, the Secretary would be required to consider both the area's economic ability to make commitments in its development plan and the extent to which an application corresponds to any State plan for revitalizing distressed areas.

2. Tax Incentives (Title II of the Bill)

a. Definition of revitalization area business

Explanation of Provision

A "revitalization area business" would be defined as a taxable entity at least 50 percent of whose gross receipts for the taxable year are attributable to the active conduct of a trade or business which produces goods, or provides services, within a revitalization area. Additionally, at least 30 percent of the employees hired by a revitalization area business after it begins to conduct business within a revitalization area (or, if later, after designation of the revitalization area) would have to be qualified employees.

"Qualified employees" would include any individual who performs at least 50 percent of his services within a revitalization area and who, immediately prior to employment by the revitalization area business, (1) had been unemployed for at least 10 weeks and was economically disadvantaged; (2) had a family income (exclusive of unemployment compensation and welfare payments) which did not exceed the lower living standard income level as determined by the Department of Labor for the applicable location and family size; (3) was (or whose family was) receiving supplemental security income or aid to families with dependent children; or (4) in the case of nonhandicapped individuals, was between 14 and 22 years of age and economically disadvantaged (or a member of an economically disadvantaged family) and required additional education, training, or counseling to secure meaningful employment. A person would be considered "economically disadvantaged" if he or his family receives (or his family income would be low enough to qualify for) Federal, State or local cash welfare payments, if he is a foster child on whose behalf State or local government payments are made, if he is a handicapped or institutionalized individual, or if he or his family has received, for the 6-month period prior to employment with the revitalization area business, total family income not in excess of the higher of (1) the poverty level determined in accordance with the criteria established by the Office of Management and Budget, or (2) 60 percent of the lower living standard income level. For purposes of defining qualified employees, persons working in jobs providing insufficient income to support their families (as determined pursuant to regulations) would be considered to be unemployed. The term "family" would include all dependents claimed by an individual on his Federal income tax return for the year prior to the year in which the individual became employed by the revitalization area business.

For a previously existing business to qualify as a revitalization area business, it would be required to employ, during the taxable year, an average number of full-time employees at least 10 percent

greater than it employed during the taxable year preceding the designation of the revitalization area. If the commencement or increase of activity by a business in a revitalization area was related to a cessation or curtailment of activity by such business in a distressed area (as identified by the Department of Housing and Urban Development), the business would not be treated as a revitalization area business unless it maintained its new level of activity in the revitalization area during the 3-year period after the commencement or increase and the business was owned by substantially the same persons during this period (without regard to any change in ownership resulting from an employee ownership plan).

b. Employee ownership tax credit

Present Law

Under present law, an employer who maintains a tax-qualified employee stock ownership plan (ESOP) is permitted a deduction (within limits) for contributions to the plan. In addition, if the employer contributes additional cash or securities to an ESOP which qualifies as a tax credit ESOP, the employer may be entitled to a payroll based tax credit for contributions to the plan.

Explanation of Provision

The bill would permit qualified corporations to elect to claim a new nonrefundable employee ownership tax credit, equal to an applicable percentage of the corporation's taxable income. The credit would be based on actual employee ownership, whether or not the employer maintained an ESOP.

The applicable percentage for any taxable year would be a percentage equal to the product of (1) 2 percent, and (2) the number of multiples of 10 percent in the employee ownership percentage for the taxable year. The bill defines the employee ownership percentage as a percentage determined by dividing the total number of shares of voting stock of the qualified corporation owned by, or on behalf of, qualified employees (see definition in item a, above) on the last day of the taxable year by the total number of shares of voting stock outstanding on the last day of the taxable year.

The amount of the credit would be subject to a number of limitations. First, the maximum amount of the credit allowed for any taxable year could not exceed $50,000. For this purpose, component members of a controlled group wou[illegible]treated as a single taxpayer; the Secretary of the Treasury wo[illegible]thorized to prescribe regulations providing for the allocati[illegible]50,000 credit among the component members. Second, [illegible] m[illegible]n amount of the credit would be limited to the taxpay[illegible]'s [illegible]ax liability, reduced by certain other nonrefundable credit[illegible]o corporation which elects to claim the payroll based [illegible] for contributions to a tax credit ESOP could elect to take [illegible] new employee ownership tax credit.

For purposes of this cre[illegible]t, the bill defines a qualified corporation as a revitalization area business (see item a, above), stock of which is owned by or on behalf of at least 70 percent of the corporation's employees.

Effective Date

The provision would apply to taxable years ending after December 31, 1983.

c. Nonrecognition of gain on certain sales of stock to employee plans

Present Law

Under present law, gain or loss from the sale or exchange of a capital asset receives special tax treatment. (See description in item II.A.2.d., above.)

Explanation of Provision

Under the bill, no gain would be recognized from certain sales or exchanges of stock in a revitalization area business. Transactions eligible for this nonrecognition treatment would include—

(1) qualifying sales or exchanges of stock in a revitalization area business by a taxpayer to or with a leveraged ESOP or tax credit ESOP which invests primarily in stock issued by that revitalization area business; and

(2) sales or exchanges of stock in a revitalization area business by a taxpayer to or with a revitalization area business which is a producer cooperative.

Under the bill, a producer cooperative is defined as an organization which is chartered and operated on a cooperative basis for the purpose of furnishing goods or services which are primarily consumed by persons other than the members of such organizations; and which provides that all employees are members of the organization.

Sales or exchanges to or with a leveraged ESOP or tax credit ESOP would qualify for nonrecognition treatment under this provision only if the following additional requirements are met:

(1) at least 51 percent of the total number of shares sold or exchanged by the taxpayer to or with the plan must be allocated to the accounts of nonmanagerial employees;

(2) at least 51 percent of the total shares of stock in the revitalization area business held by the plan must be allocated among at least 51 percent of the nonmanagerial employees;

(3) if the sale or exchange is to or with a tax credit ESOP, all employees to whom the shares are allocated must receive a nonforfeitable right to those shares within 5 years after the date of the sale; and

(4) the taxpayer must maintain such records and provide such information to the Secretary of the Treasury as the Secretary may by regulations require.

For purposes of these provisions, nonmanagerial employees include all employees other than those who are officers or those whose compensation exceeds a specified dollar limit ($60,000 for 1983).

Effective Date

The provision would apply to taxable years ending after December 31, 1983.

d. Rollover of gain reinvested in qualified property

Present Law

Under present law, gain or loss from the sale or exchange of a capital asset receives special tax treatment.

Present law generally does not categorize gains or losses with regard to the location of an asset, or the specific purpose for which it is used. In certain instances, however, present law allows nonrecognition, or rollover, of gain from the sale of property, such as a taxpayer's principal residence, to the extent that the proceeds are reinvested in a specified manner. In these instances, the rules operate to defer, rather than eliminate, tax on the sale of the asset.

Explanation of Provision

The bill would provide for nonrecognition of gain on the sale or exchange of property by a taxpayer if the taxpayer purchases qualified property within a period beginning 3 months prior to the date of the sale or exchange and ending 21 months after that date. The rule would apply only to the extent of the cost of the qualified property.

"Qualified property" would include (1) tangible personal property acquired by the taxpayer after designation of a revitalization area, and used predominantly by the taxpayer in that area in the active conduct of a trade or business; (2) real property located in a revitalization area, which was acquired by the taxpayer after designation of the area and used predominantly by the taxpayer in the active conduct of a trade or business; and (3) stock of a corporation, or an interest in a partnership or other business, if, for the most recent taxable year ending before the date of acquisition of such interest, the business was a small revitalization area business (defined as a revitalization area business having average annual gross receipts not exceeding $4,000,000 over a 3-year period). Additionally, qualified property would include certain forms of low-income rental housing which is located in a revitalization area and which was built, or significantly rehabilitated, after the designation of the area.

Under the bill, the special treatment for sales or exchanges of qualified property would not terminate when the designation of the revitalization area in which the property was used or located ceased to apply. However, the special treatment would not apply after the first sale or exchange of the property after the designation ceased to apply.

If gain on the sale or exchange of property was not recognized because the taxpayer acquired property, the taxpayer's basis in the qualified property would be the cost of the qualified property de-

creased by the amount of unrecognized gain. The rule would thus defer tax on the unrecognized gain.

Effective Date

The provision would apply to taxable years ending after December 31, 1983.

e. Investment tax credit for certain low-income rental housing

Present Law

An investment tax credit applies to eligible tangible personal property used in a trade or business or for the production of income. (See description in item II.A.2. c, above.)

Explanation of Provision

A 10-percent investment tax credit would be allowed for investment in certain low-income rental housing located in a revitalization area. For purposes of this credit, low-income rental housing generally would include any building, financed with subsidized financing, in which the dwelling units are rented to families and individuals of low or moderate income who are eligible to receive subsidies from the Federal Government or any State. In addition, similar property designated by the Secretary of Housing and Urban Development could qualify as low-income rental housing. In order to be eligible for this credit, the property would have to be located in an revitalization area and constructed or rehabilitated after designation of the area. Property would not cease to be qualified solely as a result of the fact that the designation of the area as a revitalization area ceases. The cost of the rehabilitation would have to be at least $10,000 per unit with respect to each project (or $3,000 in the case of certain State or local agency financed projects).

Effective Date

The provision would apply to periods after December 31, 1983.

f. Investment tax credit for establishment of entrepreneurial development centers

Present Law

An investment tax credit applies to eligible tangible personal property used in a trade or business or for the production of income. (See description in item II.A.2.c., above.)

Explanation of Provision

An investment tax credit would be allowed for the establishment of an entrepreneurial development center. For purposes of this credit, an entrepreneurial development center would mean a facility which (1) is located in a revitalization area; (2) is placed in service within 24 months after establishment of the area; (3) is privately owned and operated for profit; (4) provides advice to revitalization area businesses regarding management techniques, financing, marketing, taxation, job training, and other matters; (5) maintains a professional staff to provide such advice; (6) employs at least one employee or consultant with expertise in the legal, managerial, and financial needs of a variety of businesses; (7) provides physical resources such as machinery, computer services, laboratories, and office space; (8) consults with the local government regarding the needs of the businesses within the revitalization area; and (9) charges a reasonable fee for the services provided by the center.

The amount of the investment credit would be 10 percent of the expenditures incurred to establish the entrepreneurial development center, but could not exceed $750,000. Special rules would apply to the allocation of the credit limitation between members of a controlled group.

The bill would provide a special rule to prevent recapture of the investment tax credit when an area ceases to be designated as a revitalization area.

Effective Date

The provision would apply to periods after December 31, 1983.

g. Tax credit for employment of qualified employees

Present Law

Under present law, there are no provisions under which an employer's Federal income tax liability varies according to the location of its employees. The targeted jobs credit provides a tax credit for a portion of wage payments made to certain groups of employees. (See description in item II.A.2.a., above.)

Explanation of Provision

The provision would allow a revitalization area business to elect to take a nonrefundable credit against tax equal to the aggregate qualified compensation paid to all revitalization area employees of the business during the taxable year. A revitalization area employee would be a qualified employee (see definition in item IV.B.2.a, above) who is hired by the revitalization area business after the later of either (1) the date on which the revitalization area business begins the active conduct of a trade or business within a revitalization area, or (2) the date on which any area in which the revitalization area business is actively engaged in the conduct of a trade or business is designated as a revitalization area.

For purposes of the provision, qualified compensation, with respect to any revitalization area employee, would be an amount equal to the applicable percentage of the aggregate compensation paid by the revitalization area business to such employee during the taxable year of the business.

The applicable percentage would vary, in accordance with the following table, depending upon how long the employee has been employed by the business.

If at the end of the taxable year the employee has been employed by the business for:	The applicable percentage is:
Less than 1 year	40
At least 1 year but less than 2 years	30
At least 2 years but less than 3 years	20
At least 3 years but less than 4 years	10
4 years or more	0

The credit would not be available for any employee with respect to whose wages credit has been allowed for any taxable year under the targeted jobs credit (see item II.A.2.a, above.)

Effective Date

The provision would be effective for taxable years ending after December 31, 1983.

h. Deduction for purchase of revitalization area business stock and debentures

Present Law

For purposes of computing taxable income, items may be deducted from gross income only when specifically authorized. When income is generated by a business enterprise, the ordinary and necessary expenses paid or incurred in carrying on the trade or business generally are allowed as deductions from such business income. When income is derived from the sale or other disposition of a capital asset, the amount of gain or loss includible in taxable income is generally the amount received from the sale or other disposition less the taxpayer's adjusted basis in the property. Gains from the sale of a capital asset (capital gains) are accorded certain preferential tax treatment. However, capital losses are given less generous treatment than other losses (ordinary losses).

Under present law, a special rule is provided for an individual who invests in certain small business stock (section 1244 stock). If an individual incurs a loss on section 1244 stock that would otherwise be treated as a capital loss, such loss is treated as an ordinary loss. For purposes of this provision, section 1244 stock must generally be common stock in a domestic corporation in which the capital and paid-in surplus does not exceed $1 million and, for the 5 years prior to the date of the loss, receives less than 50 percent of its income from passive sources.[1]

Explanation of Provision

An individual, or partnership of individuals, would be allowed to deduct an amount equal to the purchase price of small revitalization area business stock or debentures for the purpose of computing taxable income. Only the original purchaser would be entitled to this deduction. The maximum amount allowable as a deduction could not exceed $10,000 ($20,000 in the case of a joint return). Purchase of the stock or debentures would be deemed to have been made on the last day of the taxable year provided that payment is made not later than the time for filing of the return (including extensions) for that year. The basis of the stock or debentures would be reduced by the amount of the deduction allowed. In cases in which stock or debentures are received in exchange for property in a transaction in which the basis of the stock or debentures determined by reference to the taxpayer's basis in the property, the deduction would be reduced by the excess (if any) of the adjusted basis of the stock or debentures over its fair market value.

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[1] H.R. 4170, as reported by the Committee on Ways and Means (Rept. No. 98–432, 98th Cong., 1st Sess.) would expand the definition of section 1244 stock to include preferred stock.

For purposes of this deduction, revitalization area business stock or debentures would mean common stock or written debt instruments issued by a qualified revitalization area business issuer. The written debt instrument would have to be a general obligation of the issuer, bear a rate of interest not less than an amount prescribed by regulations, and have a fixed maturity.

A qualified revitalization area business issuer would mean a revitalization area business (1) of which the average annual gross receipts do not exceed $4 million for the 3-taxable-year period ending with the taxable year, (2) which has no securities outstanding which are subject to regulation by the Securities and Exchange Commission; and (3) which during the period of its 5 most recent taxable years derived more than 50 percent of its income from sources which are not passive sources. For purposes of determining whether a business qualifies as a revitalization area business, the outstanding stock or debentures of all members of a controlled group would be taken into account.

Proceeds from the sale of revitalization area business stock or debentures would be recaptured as ordinary income to the extent of the deduction previously allowed if the sale occurred before the close of the 3-year period beginning on the date of purchase. Otherwise, the character of the gain or loss from the sale of the stock or debentures would be determined under generally applicable principles.

Effective Date

The provision would apply to taxable years ending after December 31, 1983.

i. Amendments to targeted jobs tax credit

Present Law

The targeted jobs tax credit provides a credit equal to a portion of the first $6,000 of wages per year paid to employees who are members of specific targeted groups and who begin work for the employer before January 1, 1985. (See description in item II.A.2.a., above.)

Explanation of Provision

The bill would increase amount of wages on which the targeted jobs tax credit is computed to $10,000 per year per employee.

In addition, the targeted jobs tax credit would be made permanent.

Effective Date

The provision increasing the first-year credit would apply to wages paid after the date of enactment in taxable years ending after such date.

The provision making the credit permanent would be effective upon enactment.

3. General Stock Ownership Provisions (Title III of the Bill)

Present Law

Under the Internal Revenue Code, a State is authorized to establish a General Stock Ownership Corporation (GSOC) for the benefit of all its citizens who would be the shareholders. A GSOC may borrow money to invest in business enterprises and use the net flow of cash from operations to service and repay the loan and to distribute the remaining funds to the GSOC shareholders.

Definition of GSOC

A corporation must meet certain statutory tests in order to be treated as a GSOC. First, the corporation must be chartered by an official act of the State legislature or by a State-wide referendum. Second, the GSOC's corporate charter must provide for the issuance of only one class of stock, the issuance of shares only to eligible individuals and the issuance of at least one share to each eligible individual if such eligible individual does not elect within one year after the date of issuance not to receive such share. The Act also requires the charter to provide for certain restrictions on the transferability of the GSOC shares. The transfer restriction must provide that the share cannot be transferred until the earliest of (1) the expiration of 5 years from issuance, (2) death, or (3) failure to meet the State's residency requirements. In no event may shares of stock of a GSOC be transferred to nonresidents. Also, no person may acquire more than 10 shares of the GSOC's stock. Third, the GSOC must not be affiliated with any other corporation. For this purpose, a 20 percent ownership test will apply to determine affiliated status rather than the customary 80 percent test. Fifth, the GSOC must be organized after December 31, 1978, and before January 1, 1984.

An eligible individual is any individual who is a resident of the chartering State as of the date specified in the enabling legislation and who remains a resident between that date and the date of issuance of the stock. A State may define a resident for purposes of its GSOC so long as such definition is consistent with constitutional principles.

Election by GSOC

A GSOC must make an election to obtain the special statutory treatment provided for by the amendment. The election is effective for the taxable year for which it is made. The manner in which the election is to be made is to be determined by regulations promulgated by the Department of the Treasury. (Regulations relating to GSOCs have not been promulgated.) The election once made is irrevocable unless terminated with the consent of the Secretary of

the Treasury. In addition, the election is terminated if the corporation ceases to qualify as a GSOC.

The effect of the election is to exempt the corporation from Federal income taxation. Instead, the shareholders of the GSOC would report their proportionate part of the GSOCs taxable income on their Federal individual income tax returns.

Other rules for GSOC

Treated as a private corporation.—A GSOC is treated as a private corporation for Federal income tax purposes.

Computation of GSOC income.—The GSOC computes its taxable income in the same manner as a regular corporation with certain modifications. The GSOC is not eligible for a dividends received deduction nor any tax credit.

Net operating loss deduction.—The shareholders of a GSOC are not eligible to report any portion of a GSOC net operating loss on their individual income tax returns. Instead, the GSOC is entitled to a 10-year carryover of any net operating loss.

Investment tax credit and recapture of investment tax credit.—Shareholders of the GSOC are entitled to their pro rata share of the GSOC's investment tax credit. The shareholders are also personally responsiblie for any recapture of the investment tax credit. Neither the corporation nor its shareholders is entitled to the foreign tax credit.

Distribution requirements.—A GSOC is required to distribute 90 percent of its taxable income for any taxable year to its shareholders by January 31, of the next succeeding year. To the extent a GSOC fails to meet this distribution requirement, a tax equal to 20 percent of the deficiency (i.e., the difference between the required distribution and the actual distribution) is imposed on the GSOC. The amount of such tax will be allowed as a deduction to the GSOC for the year in which it is paid rather than the year of accrual.

Taxation of GSOC shareholders

Each shareholder includes in his gross income his daily pro rata portion of the GSOC's taxable income. Such income is included in the shareholder's gross income for the taxable year in which or with which the GSOC's taxable year ends. The income in the hands of the shareholder is treated as ordinary income and is not eligible for the partial dividend exclusion.

Shareholders will increase the tax basis of shares of stock in the GSOC by the amount of the GSOC taxable income which is taxed to the shareholders. This basis adjustment is made by a shareholder only to the extent an amount is actually included in gross income in his or her income tax return (unless under section 6012(a)(1), the shareholder is not required to file a return).

Explanation of Provisions

a. Definition of revitalization area GSOC

A revitalization area GSOC would be chartered by the State legislature or Governor, under terms specified in the bill, to serve the needs of each specific revitalization area and would be authorized by its charter to acquire and develop real estate in the area. The

charter would provide for issue of stock only to eligible revitalization area residents. Each share would have full voting rights. An eligible area resident would be at least 18 years old, and an area resident for at least 1 continuous year.

Eligibility for holding of shares would be prescribed for exempt and non-exempt area residents. Exempt residents could include employees of the area GSOC, individual volunteers of services for the GSOC, and disabled individuals. Each exempt resident could own 25 percent more shares than each non-exempt resident. A resident could sell stock only to the revitalization area GSOC, beginning 5 years after the date the stock is issued or when the shareholder ceases to be a resident of the revitalization area. A share could be transferred by will or by the laws of descent and distribution at any time.

The definition of the GSOC in present law is amended, to pertain also to a revitalization area GSOC. The present law provision is extended to apply to GSOCs chartered before 1995.

b. Establishment of revitalization area GSOC

A planning board would be elected within 180 days after designation of the revitalization area to decide whether to establish a GSOC. The decision would have to be made within a year of the designation. A favorable decision would result in application for a charter that would be issued by the State legislature or the Governor. The bill contains rules regarding election of a planning board and, subsequently, a board of directors.

The GSOC board of directors within 90 days would have to submit a business plan which specifies (1) the objectives of the revitalization area GSOC, (2) the type of investments that could be made by the GSOC, and (3) the manner in which the revitalization area GSOC proposes to develop the area. The plan would have to be approved by a majority of the shareholders before any action to develop the revitalization area could be taken.

c. Other provisions

A GSOC that owns stock in a real estate corporation would not be considered as a member of an affiliated group unless it owns 80 percent of each class of voting and nonvoting stock. A real estate corporation for these purposes would have to derive at least 95 percent of its gross income from rents or gains from the sale or distribution of real property during any taxable year in which a GSOC owns at least 20 percent of its stock.

A revitalization area GSOC would be required to distribute at least 10 percent of its taxable income for any taxable year.

Contributions to a GSOC by an individual would be treated as charitable contributions.

Only 50 percent of the gain realized from the sale or exchange of any property to, or with, a revitalization area GSOC would be recognized.

Effective Date

These provisions would generally apply to taxable years ending after December 31, 1983.

4. Employee Stock Ownership Provisions (Title IV of the Bill)

a. Overview of present law

An employee stock ownership plan (ESOP) is a tax-qualified plan under which employer stock is held for the benefit of employees. The stock, which is held by a tax-exempt trust under the plan, may be acquired through direct employer contributions or with the proceeds of a loan to the trust.

An ESOP which borrows to acquire employer stock is referred to as a leveraged ESOP. Under a leveraged ESOP, the employer makes contributions to the trust and is allowed a deduction, within limits, for contributions applied to pay off the loan.

An employee stock ownership plan under which an employer contributes stock or cash in order to qualify for an additional tax credit based on a percentage of payroll is referred to as a tax credit ESOP. The payroll based tax credit applies with respect to compensation paid or accrued before January 1, 1988.

Under the usual rules applicable to tax-qualified plans, an employee's benefits under an ESOP are generally not taxed to the employee until they are distributed or made available. Also, the Code provides special 10-year income averaging for lump sum distributions, deferral of tax on appreciation in employer securities, and estate and gift tax exclusions.

b. Deductible contributions to leveraged ESOP's

Present Law

An employee stock ownership plan which borrows to acquire employer stock is referred to as a leveraged ESOP. Under a leveraged ESOP, the employer is allowed a deduction, within limits, for contributions to the plan which may be applied by the plan to service the loan.

The deduction allowed an employer for contributions to a profit-sharing or stock bonus plan (including a leveraged ESOP) generally is limited to 15 percent of the aggregate compensation of all employees under the plan. However, in the case of a leveraged ESOP consisting of a stock bonus plan and a money purchase pension plan, the deduction for employer contributions to qualified plans for a year generally is limited to 25 percent of the aggregate compensation of employees covered by the plans (sec. 404(a)(7)). In addition, annual contributions and certain other additions (including forefeitures) credited to a participant's account under qualified defined contribution plans of an employer (including a leveraged ESOP) generally may not exceed the usual limits on contributions to qualified plans the lesser of $30,000 or 25 percent of the participant's compensation. In the case of certain ESOPs, the dollar limit is doubled.

The allowable deduction limit is increased for certain employer contributions applied by the plan to the payment of loans to purchase employer securities. Amounts applied to the payment of interest on a qualifying loan are allowed as a deduction without regard to an annual percent-of-compensation limit (sec. 404(a)(10)(B)). However, the deduction allowed for contributions applied to the repayment of loan principal is limited to 25 percent of the compensation of all employees under the plan (sec. 404(a)(10)(A)).

Those additional ESOP contributions which are applied by the plan to the payment of interest on a loan to acquire employer securities (but not amounts applied to loan principal), as well as any forfeitures of employer securities purchased with loan proceeds, generally are not taken into account under the rules providing overall limits on contributions and benefits under qualified plans (sec. 415(c)(6)). The rule allowing the employer contributions of loan interest and the employee forfeitures to be disregarded for purposes of the overall limitations applies only if no more than one-third of the employer's contributions for the year is allocated to the group of employees consisting of officers, shareholders directly or indirectly owning more than 10 percent of the employer's stock (other than stock held by qualified plans), or individuals whose compensation exceeds a specified limit.

Explanation of Provision

The bill would increase the allowable deduction limit for certain employer contributions applied by the plan to the payment of loans to purchase employer securities. Under the bill, the maximum deduction allowed for contributions applied to the repayment of loan principal would be increased from 25 percent to 50 percent of the compensation of all employees under the plan.

In addition, with respect to employer contributions applied to the payment of principal, the percentage limit applied the overall contributions and benefits would be increased from 25 to 50 percent of compensation. Under the bill, although annual additions on behalf of any participant generally would be limited to the lesser of 25 percent of compensation or the applicable dollar limit ($30,000 for 1983), that percentage limit would be increased to 50 percent if the increased annual additions resulted from employer contributions applied to the repayment of principal. No change would be made to the dollar limit.

Effective Date

The provision would apply to taxable years ending after December 31, 1983.

c. Treatment of dividend distributions

Present Law

Under present law, a corporation generally is not entitled to deductions for dividends paid to shareholders.

Explanation of Provision

Under the bill, a corporation would be entitled to a deduction for dividends paid during the taxable year on employer securities held (as of the record date) by a leveraged ESOP or a tax credit ESOP, provided that the dividends received by the plan are (1) distributed to the employees participating in the plan not later than 60 days after the end of the plan year in which they are received, or (2) applied by the plan to the repayment of a loan incurred to acquire employer securities.

Under the bill, a corporation also would be entitled to a deduction for dividends paid during the taxable year on employer securities held (as of the record date) by a former employee or beneficiary who received the securities in a distribution from a leveraged ESOP or a tax credit ESOP.

Effective Date

The provision would apply to taxable years ending after December 31, 1983.

d. Charitable contributions

Present Law

Under present law, a corporate employer is allowed, within certain limits, a business expense deduction for contributions to certain tax-qualified plans (including ESOPs). No person other than the employer is allowed any deduction (including charitable deductions) for such a contribution.

Explanation of Provision

Under the bill, an individual could make a contribution or bequest of employer securities to a leveraged ESOP or a tax credit ESOP, and such a contribution could qualify as a charitable contribution for purposes of the income, estate and gift taxes. Thus, those amounts would be deductible (subject to the otherwise applicable limitation on the amount of deductible charitable contributions).

To qualify, the gift or contribution would have to meet several conditions:

(1) the contribution or gift must consist exclusively of employer securities;

(2) the contribution or gift must be allocated (pursuant to the terms of the ESOP) in a nondiscriminatory fashion to the plan participants;

(3) no portion of the contribution or gift may be allocated under the plan for the benefit of the donor, or any person related to the donor (within the meaning of section 267(b)) or any person who owns more than 25 percent in value of any class of outstanding employer securities;

(4) the contribution or gift must be made pursuant to the terms of the leveraged ESOP or tax-credit ESOP;

(5) the plan must treat the donated securities as attributable to employer contributions; and

(6) no tax deduction or tax credit may be permitted to the employer with respect to such gift.

Conforming changes are made to the estate and gift tax provisions which permit charitable deductions.

Effective Date

The provision would apply to taxable years ending after December 31, 1983.

I. Energy Provisions (Title V of the Bill)

a. Residential energy tax credit

Present Law

A tax credit of 15 percent of up to $2,000 of qualified energy conservation expenditures with respect to a dwelling unit which is the taxpayer's principal residence may be taken against individual income tax liability. Qualified energy conservation expenditures include insulation, a furnace replacement burner, a device to modify flue openings, an electrical or mechanical furnace ignition system, storm or thermal exterior windows or doors, an automatic energy-saving setback thermostat, caulking or weatherstripping for exterior doors or windows, and an energy usage display meter.

A tax credit of 40 percent is available for expenditures up to $10,000 on renewable energy source property for any dwelling unit which is the taxpayer's principal residence. Renewable energy source property provides heating and cooling from solar, wind, geothermal and other renewable energy sources.

These credits apply to expenditures for qualified property made before January 1, 1986. Unused credits may be carried over to succeeding taxable years through December 31, 1987.

Explanation of Provision

The tax credit for energy conservation expenditures would be increased to 40 percent.

After the termination date in present law, December 31, 1985, the energy conservation and renewable energy tax credits would be available only for any dwelling unit within a revitalization area. Unused credits attributable to energy expenditures in revitalization areas could be carried forward through December 31, 2004.

Effective Date

The increase in the amount of credit would apply to taxable years ending after December 31, 1983.

The provision extending the credit in revitalization areas would apply to taxable years ending after December 31, 1985.

b. Increase in energy investment tax credit for revitalization area businesses

Present Law

Energy investment tax credits that vary between 10 and 15 percent presently are allowable for solar, wind or geothermal property, ocean thermal property, qualified hydroelectric generating property, qualified intercity buses, and biomass property.

These credits are scheduled to expire after December 31, 1985.

Explanation of Provision

The energy investment tax credit would be increased to 30 percent with respect to any energy property of a taxpayer which is a revitalization area business for the taxable year.

This provision would apply to eligible property for the period beginning January 1, 1984, through December 31, 2002.

Effective Date

The provision generally would apply to periods after December 31, 1983.

B. OTHER PROVISIONS

1. Direct Loans Under the Small Business Act to Revitalization Area Businesses

Present Law

Loans may be made under Small Business Act to small business for plant acquisition, construction, conversion, or expansion, including acquisition of land, materials, supplies, equipment, and working capital, and to make loans to any qualified small business concern, including those owned by qualified Indian tribes. The financings may be made either directly or in cooperation with banks or other financial institutions through agreements to participate on an immediate or deferred (or guaranteed) basis. The amounts available for the loans must be made available in advance through appropriation Acts.

Explanation of Provision

At least $50 million of the amount appropriated for new direct loan obligations under Small Business Act would be required to be obligated for small business concerns located in revitalization areas.

2. Coordination With Other Federal Programs

The Secretary of Housing and Urban Development would be assigned responsibility to promote coordination within a revitalization area among all Federal housing, community and economic development, banking, financial assistance and employment training programs. The Secretary also would be instructed to consolidate application forms in order to expedite consideration of program applications and to consolidate periodic reports required under the programs.

3. Job Training Preferences

Agency heads would be required to give certain preferences in the granting of Federal funds or contracts to any programs, organizations or local governments for the purpose of job training. The following preferences are stipulated in the bill: (1) any program, organization, or local government located or primarily serving in a revitalization area; (2) programs and organizations that are part of a revitalization area job training plan; (3) community-based organizations or entrepreneurship development centers located in or primarily serving a revitalization area. A community based organization would be a tax-exempt organization which has demonstrated effectiveness in the delivery of employment and training services.

Each agency head would be required to take actions to assure that recipients of Federal funds or contracts for job training give special consideration to the above preferences in any further distribution of the funds.

IV. DESCRIPTION OF H.R. 2375

(ENTERPRISE DEVELOPMENT AND INDUSTRIAL REVITALIZATION ACT OF 1983)

A. REVENUE PROVISIONS (TITLE III OF THE BILL)

1. Designation of Job Expansion Areas and Businesses

Present Law

The Internal Revenue Code contains several provisions which provide special tax treatment in specific geographic areas. (See description in item II.A.1., above.)

Explanation of Provisions

In general, the special tax treatment provided by the bill would apply in connection with activities of qualified job expansion businesses in job expansion areas.

a. Definition of job expansion areas

A job expansion area would be any area in the United States that is designated by the appropriate local government or governments, has a population of at least 5,000, and is approved by the Secretary of Commerce (Secretary) pursuant to application procedures prescribed by the Secretary.

The Secretary would be required to designate a total of 75 job expansion areas—25 areas per 12-month period during the 3-year period which follows the date of enactment of the bill.

b. Period of effect of designation

A designation of an area as a job expansion area would remain in effect for 10 years, beginning on the date the Secretary approves the designation.

c. Area requirements

An area would have to meet four requirements before the Secretary could approve its designation as a job expansion area. The area would have to be within the jurisdiction of the designating local governments, have a continuous boundary, and be in an incorporated area with a population of 10,000 or more. In addition, the unemployment rate in the area would have to have exceeded the national rate by an average of 1 percentage point or more for the most recent 2-year period for which statistics are available, or the area would have to have experienced (or be about to experience) a sudden economic dislocation that results in a significant loss of jobs.

d. Definition of qualified job expansion business

A person that is actively engaged in the conduct of a trade or business would be a qualified job expansion business if qualified employees provide at least 50 percent of the hours worked by all employees and (unless waived by the Secretary) at least 50 percent of the hours worked by qualified employees are provided by residents of a job expansion area. For purposes of applying these tests, separate branches of a business would be treated as separate businesses.

An employee would be a qualified employee of an employer if substantially all of his or her work is performed in a trade or business of the employer in one or more job expansion areas.

2. Additional Expensing of Personal Property

Present Law

Instead of recovering costs of depreciable property under the ACRS system and claiming an investment credit, a taxpayer (other than a trust or estate) can elect to treat the cost of qualifying property as an expense that is not chargeable to capital account. For taxable years beginning in 1983, a $5,000 limitation is imposed on the amount that can be expensed a year ($2,500 in the case of a married individual filing a separate return). For taxable years beginning in 1984 and 1985, the dollar limitation is $7,500 ($3,750 for a married individual filing a separate return). For taxable years beginning in 1986 and later years, the dollar limitation is $10,000 ($5,000 for a married individual filing a separate return).

In general, the property for which an election can be made is recovery property that is acquired by purchase for use in a trade or business, and that is otherwise eligible for the regular investment tax credit. (See item II.A.2.c. above.) The election is not available for property held merely for the production of income.

Explanation of Provision

Under the bill, a qualified job expansion business would have an election to expense an additional $50,000 of job expansion area property. Job expansion area property is defined as property used predominantly in an area which is a job expansion area as of the time the property is placed in service. To qualify for the additional expensing allowance, a taxpayer would be required to specify the items of property (and the portion of the costs of such property) to be taken into account.

If property for which the additional allowance was elected ceases to be used in a job expansion area before the end of the property's recovery period, the tax benefits previously obtained by expensing would be recaptured. No recapture would be required upon the termination of an area's designation as a job expansion area.

Effective Date

The bill would apply to taxable years ending after December 31, 1982.

3. Investment Tax Credit for New Buildings

Present Law

An investment tax credit applies to eligible tangible personal property or expenditures for the rehabilitation of certain buildings used in a trade or business or for the production of income. (See description in item II.A.2.c., above.)

Explanation of Provision

A 10-percent investment credit would be available for a new building (or structural components of a building) that is placed in service in a job expansion area for a taxable year in which the taxpayer qualifies as a job expansion business.

Effective Date

The bill would apply to taxable years ending after December 31, 1982.

4. Additional Used Property Eligible for Investment Tax Credit

Present Law

An investment tax credit applies to eligible tangible personal property or expenditures for the rehabilitation of certain buildings used in a trade or business or for the production of income. (See description in item II.A.2.c., above.)

Dollar limitations are imposed on the amount of used property that can qualify for the regular investment credit in each year. The limitation is $125,000 for taxable years beginning in 1983 or 1984, and $150,000 for property placed in service in later years.

Explanation of Provision

Under the bill, a qualified job expansion business could elect to increase the used property limitation on the investment credit by $400,000. The election to increase the dollar limitation on the investment credit would be available only for the cost of property that is used predominantly in an area that is a job expansion area as of the time the property is placed in service.

Effective Date

The bill would apply to taxable years ending after December 31, 1982.

5. Investment Tax Credit for Rehabilitation Expenditures

Present Law

An investment tax credit applies to eligible tangible personal property or expenditures for the rehabilitation of certain buildings used in a trade or business or for the production of income. (See description in item II.A.2.c., above.)

Explanation of Provision

Under the bill, as an alteration to the 15-, 20-, and 25-percent rehabilitation credits for buildings which are at least 30 years old, 40 years old, or historic, respectively, a 25-percent credit would be provided for expenditures incurred for the rehabilitation of a building that is at least 20 years old. The 25-percent credit would be available for expenditures incurred by a qualified job expansion business, in connection with the rehabilitation of a building that is located in a job expansion area.

Effective Date

The bill would apply to taxable years ending after December 31, 1982.

6. Limited Refundability of Investment Tax Credit

Present Law

An investment tax credit applies to eligible tangible personal property or expenditures for the rehabilitation of certain buildings used in a trade or business or for the production of income. (See description in item II.A.2.c., above.)

In general, the investment tax credit allowable in any taxable year is limited to a percentage of the taxpayer's tax liability as computed before taking the credit into account. Excess credits can be carried back or carried over for use against tax liabilities in other taxable years. The tax liability limitation and the carryback and carryover rules are applied separately to (1) the regular and rehabilitation investment credits, and (2) the energy investment credit.

In general, the sum of the regular and rehabilitation investment credits is limited to up to $25,000 of the taxpayer's tax liability plus 85 percent of tax liability in excess of $25,000. If a taxpayer has energy investment credits, those credits can be used to offset 100 percent of any tax liability remaining (after reduction by the sum of the regular and rehabilitation credits).

Explanation of Provision

Under the bill, up to $250,000 of investment credit attributable to property located or predominantly used in a job expansion area would be treated as a refundable credit. In addition, the tax liability limitation and the carryback and carryover rules would be applied first to the regular and rehabilitation credits, second to energy credits, and then to the credit allowed for job expansion area property.

Effective Date

The bill would apply to taxable years ending after December 31, 1982.

7. Tax Credit for ESOP Contributions of Area Businesses

Present Law

Under present law, an employee stock ownership plan (ESOP) is a tax-qualified plan under which employer stock is held for the benefit of employees. An employer who maintains a tax-qualified ESOP is permitted a deduction (within limits) for contributions to the plan. In addition, if the employer contributes cash or securities to an ESOP that qualifies as a tax-credit ESOP, the employer may be entitled to a tax credit for 100 percent of contributions, limited to a prescribed percentage of the aggregate compensation of all employees under the plan (i.e., a payroll based tax credit).

For compensation paid or accrued in calendar years 1983 and 1984, the tax credit is limited to one-half of one percent of aggregate compensation. With respect to compensation paid or accrued in 1985, 1986, and 1987, the limit is three-quarters of one percent. No credit is provided with respect to compensation paid or accrued after December 31, 1987.

Explanation of Provision

The bill would raise the percentage of aggregate compensation to which the ESOP tax credit is limited to two percent during the period in which a business is designated as a qualified job expansion business. This percentage would apply for all periods after 1982.

Effective Date

The provision would apply to taxable years ending after December 31, 1982.

8. Tax Credit for Job Expansion Area Employers

Present Law

Under present law, there are no provisions under which an employer's Federal income tax liability varies according to the location of its employees or its change in employment. However, a provision in effect in recent years did provide a credit which varied with an employer's increased employment. In addition, the present law targeted jobs tax credit provides tax incentives for hiring specific groups of individuals. (See item II.A.2.a., above.)

Explanation of Provision

In general

Under the bill, employers in job expansion areas would be eligible to claim a tax credit equal to the sum of two parts — (1) an amount based on the increase in annual wages paid to employees working in the job expansion area relative to wages paid to area employees in the period immediately before designation as a job expansion area, and (2) an amount based on wages paid to certain displaced workers in the job expansion area. The credit would be limited to the taxpayer's tax liability. Unused credits could be carried back for 3 years or carried forward for the longer of 15 years or the remainder of the period during which the job expansion area designation is in effect.

Qualified wages and qualified employees

The computation of both parts of the credit would be based on the amount of qualified wages paid to qualified employees.

A qualified employee would be any employee 90 percent or more of whose services directly relate to the conduct of the employer's trade or business located in a job expansion area and who performs at least 50 percent of his services in a job expansion area. Qualified employees would not include employees with respect to whom the employer claims the targeted jobs credit.

Qualified wages generally would include amounts subject to FUTA (Federal Unemployment Tax Act) taxes, without regard to any dollar limit (currently $7,000 per year per employee). Special rules would be provided for wages paid in connection with agricultural and railway labor not covered by FUTA. Those rules would be similar to the rules presently in effect for purposes of the targeted jobs credit. Qualified wages for any period would not include federally funded on-the-job training payments which the employer receives or is entitled to receive with respect to a qualified employee.

Credit for increased job expansion area employment

The first part of the credit would be equal to 10 percent of the excess of qualified wages paid or incurred during the taxable year to qualified employees in all job expansion area over base period wages with respect to all such areas. For purposes of this part of the credit, qualified wages could not be taken into account if they were taken into account in determining the amount of the credit for wages paid to displaced workers.

Base period wages, for any job expansion area, would be the amount of wages paid during the 12-month period prior to area designation (or, if earlier, the date on which the job expansion area is designated under State law enacted after January 1, 1981) and which would have been qualified wages paid to qualified employees if the designation had been in effect during this period. If the employer had no active trade or business in an area during such period, base period wages for that area would be zero.

Qualified wages taken into account for purposes of this portion of the credit could not exceed 2 1/2 times the FUTA wage base in effect for the calendar year ending in the taxable year for which the credit computation is made. This limit would be used for the computation of base period wages as well as for the computation of current period qualified wages. Thus, if the FUTA wage base were increased from one year to the next, the amount of base period wages used in computing the credit for the second year would be recomputed to reflect the higher limit on the amount of wages per employee which could be taken into account.

The first portion of the credit would be phased out over a 4-year period starting in the taxable year during which falls the tenth anniversary of the area designation. For this taxable year, the credit would be reduced to 7 1/2 percent of qualified wages. The credit would then be reduced by 2 1/2 percentage points for each succeeding year until terminated.

Credit for wages paid to displaced workers

The second part of the credit would be computed with respect to qualified wages paid to qualified employees who are also qualified displaced workers.

This portion of the credit would be allowable for a total of seven years with respect to any employee. The credit would be equal to 50 percent of qualified wages paid to a qualified displaced worker for services performed during the 36-month period beginning on the day the individual began work for an employer in a job expansion area. The credit would then be reduced 10 percentage points during each of the succeeding twelve-month periods, i.e., to 40 percent of qualified wages attributable to services rendered in the fourth year, 30 percent of qualified wages attributable to services rendered in the fifth year, 20 percent of qualified wages attributable to services rendered in the sixth year, and 10 percent of qualified wages attributable to services rendered in the seventh year. The credit would not be available after the seventh year of employment. These time periods would not take into account any period of time during which the individual is unemployed or is employed by a taxpayer in a job expansion area designated under a State law

enacted after January 1, 1981 (if this designation occurred prior to the Federal designation).

For purposes of this portion of the credit, a qualified displaced worker would be any qualified employee who is hired to perform services in an area for which a job expansion area designation is in effect and who (1) has been terminated or laid off from employment or received a termination or layoff notice, and is unlikely to return to his previous industry or occupation, (2) has been terminated or has received a notice of termination of employment as a result of any permanent closure of a plant or facility, (3) is a long-term unemployed individual and has limited opportunities for employment or reemployment in the same or a similar occupation in the area in which the individual resides (including any individual who may face substantial barriers to employment by reason of age), or (4) is a member of a targeted group as defined for purpose of the targeted jobs credit (sec. 51(d)).

This part of the credit would be phased out over the same 4-year period as the credit for increased job expansion area employment. This would be accomplished by reducing the amount of the credit by 25 percent in the first year in which the increased employment credit begins to phase out and a further 25 percent in each succeeding year.

Special rules

Rules analogous to those applying for purposes of the present targeted jobs credit and research and experimental expenditures tax credit would control computation and allocation of the credit for controlled groups of businesses, for subchapter S corporations and their shareholders, for estate and trusts and their beneficiaries, and for employers affected by acquisitions and dispositions. Special rules also would be provided for taxpayers with respect to which a job expansion area designation is in effect for only part of the taxable year and for taxpayers with a short taxable year.

Any credit taken with respect to an employee would be recaptured if the employee is terminated during the first 270 days after the employee begins work for the employer. Exceptions would be provided for voluntary termination, disability, or misconduct of the employee, or substantial reduction of the business. If the major portion of a trade or business or of a separate unit of a trade or business were acquired by another employer, and the employee continued to be employed in that trade or business, employment would not be terminated for purposes of the credit.

The amount of any deduction allowable to a job expansion area employer for wages paid to employees would be reduced by the amount of credit allowable under this provision.

Effective Date

The provision would apply in taxable years beginning after December 31, 1982.

9. Tax Credit for Job Expansion Area Employees

Present Law

Under present law, the tax liability of an employee working in the United States generally does not vary according to the location of his employment. However, a refundable credit (the earned income credit) is allowed to certain low-income families with children. (See item II.A.2.b., above.)

Explanation of Provision

Under the bill, qualified employees would be entitled to claim a nonrefundable tax credit equal to 5 percent of qualified wages for the taxable year. For purposes of this credit, qualified wages would be equal to all remuneration paid for services of a qualified employee (but not including any compensation received from the Federal Government or any State or political subdivision) up to 1 1/2 times the FUTA wage (currently $7,000). Thus, the maximum credit for any taxable year, using the current FUTA wage base, would be 5 percent of $10,500 or $525.

For purposes of this credit, a qualified employee would be an individual at least 90 percent of whose services are directly related to a trade or business in a job expansion area and at least 50 percent of whose services are performed in such an area, and who is not an employee of the Federal Government or any State or political subdivision. The determination of whether an individual was a qualified employee would be made separately with respect to each of the individual's employers.

The credit would be phased out ratably over a 4-year period starting in the taxable year of the employee in which fell the tenth anniversary of designation as a job expansion area.

Effective Date

The provision would apply in taxable years beginning after December 31, 1982.

10. Deduction for Purchase of Job Expansion Area Business Stock and Debentures

Present Law

For purposes of computing taxable income, a deduction generally is not allowed for purchases of stock or debentures. However, special rules are provided for the deduction of losses recognized on certain small business stock. (See description in item III.A.2.h., above.)

Explanation of Provision

An individual, or partnership of individuals, would be allowed to deduct an amount equal to the purchase price of job expansion area business stock or debentures for the purpose of computing taxable income. Only the original purchaser would be entitled to this deduction. The maximum amount allowable as a deduction could not exceed $20,000 ($40,000 in the case of a joint return). Purchase of the stock or debentures would be deemed to have been made on the last day of the taxable year, provided that payment is made not later than the time for filing of the return (including extensions) for that year. The basis of the stock or debentures would be reduced by the amount of the deduction allowed. In cases in which stock or debentures are received in exchange for property in a transaction in which the basis of the stock or debentures is determined by reference to the taxpayer's basis in the property, the deduction would be reduced by the excess (if any) of the adjusted basis of the stock or debentures over its fair market value.

For purposes of this deduction, job expansion area business stock or debentures would mean common stock or written debt instruments issued by a qualified job expansion area business issuer. The written debt instrument would have to be a general obligation of the issuer, bear a rate of interest not less than an amount prescribed by regulations under section 483(c)(1)(B), and have a fixed maturity.

A qualified job expansion area business issuer would mean a job expansion area business (1) of which the average annual gross receipts do not exceed $5 million for the 3-taxable-year period ending with the taxable year; (2) which has no securities outstanding which are subject to regulation by the Securities and Exchange Commission; and (3) which during the period of its 5 most recent taxable years derived more than 50 percent of its income from sources which are not passive sources. For purposes of determining whether a business qualifies as a job expansion area business, the outstanding stock or debentures of all members of a controlled group would be taken into account.

Proceeds from the sale of job expansion area business stock or debentures would be recaptured as ordinary income to the extent

of the deduction previously allowed if the sale occurred before the close of the 3-year period beginning on the date of purchase. Otherwise, the character of the gain or loss from the sale of the stock or debentures would be determined under generally applicable principles.

Effective Date

The provision would apply to taxable years ending after December 31, 1982.

B. OTHER PROVISIONS

1. Amendment of Public Works and Economic Development Act of 1975 (Title I of the Bill)

Explanation of Provision

a. Development investment assistance

The bill would authorize appropriations for a program of grants for development investment assistance.

Eligible activities.—Grants could be made to applicants for public facilities, revolving loan funds for private small business, preparation for development of a project and enhancement of investment climate, and assistance to address and prevent economic dislocation and facilitate economic adjustment. State and local governments, economic development districts, and Indian tribes could apply for grants if certain distress criteria are met.

Distress criteria.—Areas for which grants are made would have to meet either of two distress criteria: (1) an area has an unemployment rate one percent above the national average percentage for the recent 24-month period, or (2) the area has experienced, or is about to experience, a sudden economic dislocation resulting in significant job loss and significant effect on the area employment rate.

Development investment strategy and criteria for grants.—Grant applicants must prepare a development investment strategy for the area for which the grant is sought. This must identify past development problems of the area and strategies to address them, taking account of the area's land availability, public facilities, low-cost capital, tax policy, skill level of the labor force, and ability of State or local governments to provide financial assistance. The strategy also would have to discuss projects necessary for implementation and the resources available for these projects.

Criteria for approving project grants would include the severity of area distress, private sector resources, State and local government commitments, effectiveness of the development investment strategy in contributing to long-term growth and employment opportunities, and the extent to which assistance allows an employee ownership organization to obtain majority ownership of a business.

Financing.—The Secretary of Commerce would be authorized to make grants for up to 50 percent of the cost of completing a project, as the cost is determined at the time of the grant application. The bill would authorize appropriations for development investment assistance of $425 million for each of fiscal years 1984, 1985 and 1986.

Not more than 25 percent of the amount appropriated for any fiscal year could be made available for a program private sector incentives, allowing grants to establish revolving fund for making or

guaranteeing loans for small business. Not more than 15 percent of the total appropriation may be spent in any one State, but these amounts would not include grants made to an Indian tribe within the State. The annual limit on grants to any person, public organization, or State or local government is $2,000,000 in any fiscal year, other than grants that promote qualified employee ownership organizations.

b. Investment strategy, planning, evaluation, and demonstration

Investment strategy and planning.—The Secretary of Commerce would be authorized to make grants for economic development planning, including the development of investment strategies. The several governmental and private organizations eligible for grants or prospective beneficiaries or participants in a project would be required to develop comprehensive and mutually consistent development plans and investment strategies in consultation with one another.

Financing.—For the purposes of this title, the bill authorizes appropriations of $75 million for each of fiscal years 1984, 1985 and 1986, and these funds would continue to be available until spent. Up to $15 million each year would be available to the Secretary to conduct evaluation and demonstration programs of development investment efforts and strategies. Any grant could not exceed 75 percent of the cost of economic development planning or preparing development investment strategy.

c. Administration

The bill would authorize appropriations for salaries and administrative expenses of $30, $35 and $45 million, respectively, for fiscal years 1984, 1985 and 1986. Other sections of this title relate to definitional, procedural and regulatory matters which include the appointment of a new Assistant Secretary of Commerce, consultations, Secretarial powers, certifications, savings provisions, filing of annual reports, maintaining records, auditing, and requirement that prevailing local wage rates (as determined under the Davis-Bacon Act) should be paid by contractors and subcontractors.

2. Amendments to the Small Business Act and Small Business Investment Act of 1958 (Title II of the Bill)

Explanation of Provision

SBA would be authorized to make an enterprise development loan directly to a small qualified job expansion business. An applicant for this type of loan would have to give reasonable assurance that it would create employment opportunities not later than 2 years after loan disbursement. The loans could be used for acquisition of a plant, land, material, supplies, equipment and working capital.

No borrower would be allowed to have an outstanding amount of SBA loans greater than $750,000 including any enterprise development loan. An enterprise development loan could not exceed $500,000, and would have to be accompanied by additional non-Federal funds. For a loan up to $200,000, the non-Federal share would have to be at least 10 percent; for loans between $200,000 and $400,000, a non-Federal share at least 20 percent would be needed, and at least 30 percent would be required for loans over $400,000. If non-Federal source funds include State or local government funds, including tax-exempt debt, 20 and 30 percent, above, would be reduced to 10 and 15 percent.

The Small Business Investment Act of 1958 would be amended with the addition of a new paragraph relating to a qualified job expansion business. The amendment would increase the ratio of purchased or guaranteed debentures to paid-in capital for small business investment companies that lend to qualified job expansion businesses.

V. ISSUES

Several issues arise in connection with the consideration of proposals to target tax incentives to particular geographic areas. A brief list of issues includes:

(1) What should be the process and the criteria for identifying targeted or distressed areas?

(2) Should targeted provisions be designed primarily to promote increased levels of economic activity within the areas or to increase the employment opportunities of residents of the areas?

(3) What are the relative advantages and disadvantages of tax incentives as compared with direct grant, loan, and loan guarantee programs in addressing the problems of distressed areas?

(4) What types of tax incentives are most likely to efficiently and effectively aid in the revitalization of a distressed area? Conversely, what types of areas are most likely to be aided by tax incentives?

(5) What effects will a targeted area tax program have on businesses and workers located outside the zone? Is it fair to similarly situated taxpayers outside targeted areas to have a special preferential tax rules apply in a limited number of distressed areas?

(6) How precisely can the revenue effect associated with any particular program of tax incentives for distressed areas be predicted?

(7) Should existing tax incentives, such as the tax exemption for industrial development bonds, be targeted to distressed areas?

APPENDIX

AREA ELIGIBILITY CRITERIA FOR URBAN DEVELOPMENT ACTION GRANTS (UDAG)

The Urban Development Action Grant (UDAG) program provides grants for economic revitalization and neighborhood reclamation projects. The projects must be located in jurisdictions or areas which meet certain minimum standards of physical and economic distress and which demonstrate provision of housing for low and moderate income individuals and equal opportunity in housing and employment. Currently, more than 350 central cities and other cities of population over 50,000 and more than 8,000 smaller cities pass the minimum standards of physical and economic distress.

Area Eligibility Factors

The statute authorizing the program specifies six factors to be taken into account in determining an area's eligibility, and the Secretary of Housing and Urban Development provides by notice the numerical levels of these factors which are required for eligibility. The six factors currently in effect are as follows:

a. Poverty rate.—At least 10.87 percent of the population of the jurisdiction have incomes at or below the poverty level, based on 1970 Census data; for small cities (categories 2 and 3, below), at least 11.99 percent, based on 1980 Census data.

b. Age of housing.—At least 33.98 percent (33.81 in small cities) of the jurisdiction's year-round housing units were constructed prior to 1940, based on U.S. Census data.

c. Growth in per capita income.—The net increase in per capita income for the period 1969 to 1977 must have been $2,683 or less, based on U.S. Census data; for small cities, the net increase in per capita income for the period 1969–1979 must have been $4,062 or less.

d. Population growth.—For the period 1970–1980, the population growth must have been 1.13 percent or less in small cities or 19.82 percent or less in large cities or urban counties for the period 1960–1980.

e. Employment growth in retailing and manufacturing.—The rate of growth in retail and manufacturing employment for the period 1972 to 1977 must have been 6.75 percent or less; for small cities greater than 25,000 in population, 6.84 percent or less.

f. Unemployment rate.—The 1981 unemployment rate must have been at least 7.24 percent, based on Bureau of Labor Statistics data.

Eligibility Criteria

Eligibility criteria depend in part on area population:

1. Large cities and urban counties.—A city with a population of at least 50,000, a central city of a metropolitan statistical area, or an urban county must meet at least three of the above six criteria. If the poverty rate is less than half the figure above (item (a)), then the area must meet at least four of the remaining five criteria.

2. Cities of population between 25,000 and 50,000.—Cities with population between 25,000 and 50,000 and which are not in category 1 must meet at least three of the first five criteria. If the poverty rate is less than half the figure above (item (a)), then the area must meet all four of the criteria (b) through (e), above. If the poverty rate is at least double the figure above (item (a)), the city also must meet only one of the the criteria (b) through (e), above. If the percentage of housing units constructed prior to 1940 is at least double the figure above (item (b)), then the city also must meet only the poverty rate criterion (item (a)).

3. Cities of population under 25,000.—A city under 25,000 must meet three of the first four criteria (items (a) through (d)). If the poverty rate is at least double the figure in item (a) above, then the city must meet only one of the other three criteria. If the percentage of housing units constructed prior to 1940 is at least double the figure above (item (b)), then the city must also meet only the poverty rate criterion (item (a)).

4. Areas within ineligible cities.—Severely distressed areas within otherwise ineligible communities may be designated as "pockets of poverty" and thus made eligible. The area must be composed of contiguous census tracts, enumeration districts or block groups. In urban counties and cities of population over 50,000, the area must contain at least 10,000 persons or 10 percent of the jurisdiction's population, whichever is lower. For smaller cities, the area must contain the greater of 2,500 persons or 10 percent of the jurisdiction's population. For all cities, no enumeration district or block group with a median income level greater than 120 percent of the jurisdiction's median income may be included in the pocket of poverty. In addition, at least 70 percent of the households in the area must have incomes below 80 percent of the jurisdiction's median income, and at least 30 percent of area residents must have incomes below the poverty level.

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